

Revisionary Test Paper_Intermediate_Syllabus 2012_Dec2013

Group - I Paper 7 - Direct Taxation

Section A – Income Tax

1.

- (a) Adhaar Ltd. engaged in the business of manufacture of tyres for motor vehicles since 1997. The company furnishes the following information for the previous year 2012-13:

	Block 1	Block 2	Block 3
Number of assets in the block	20	12	15
Rate of depreciation	60%	30%	15%
W.D.V. as on 1 st April, 2012 (₹)	8,00,000	30,00,000	20,00,000
Plant A purchased and put to use on 15.05.2012 (₹)	—	—	50,00,000
Plant B (Second Hand Machinery) purchased and put to use on 20.09.2012 (₹)	—	10,00,000	—
Plant C purchased and put to use on 25.10.2012 (₹)	10,00,000	—	—
Sale of old plant (₹)	19,50,000	35,00,000	15,00,000

Find out the amount of depreciation, additional depreciation and capital gains.

Solution:

Computation of additional depreciation

	Plant A	Plant B	Plant C
Whether additional depreciation is available	Yes	No	Yes
Rate of additional depreciation	20%	—	10%
Actual Cost (₹)	50,00,000	10,00,000	10,00,000
Additional Depreciation (₹)	10,00,000	—	1,00,000

Computation of normal depreciation

	Block 1	Block 2	Block 3
Rate of additional depreciation	60%	30%	15%
W.D.V. as on 1 st April, 2012 (₹)	8,00,000	30,00,000	20,00,000
Add: Purchase during the year (₹)	10,00,000	10,00,000	50,00,000
Total (₹)	18,00,000	40,00,000	70,00,000
Less: Sale proceeds of old plants (₹)	19,50,000	35,00,000	15,00,000
W. D. V. as on 31 st March, 2013 (₹)	Nil	5,00,000	55,00,000
Less: Normal Depreciation (₹)	Nil	75,000	8,25,000
Additional Depreciation (₹)	1,00,000	—	10,00,000
W. D. V. as on 1 st April, 2013 (₹)	Nil	4,25,000	36,75,000

Computation of Capital Gains

	Block 1 (₹)	Block 2 (₹)	Block 3 (₹)
Whether capital gain is taxable	Yes	No	No
Sale proceeds of old plants	19,50,000	35,00,000	15,00,000
Less: Cost of acquisition	18,00,000	—	—
Short Term Capital Gains	1,50,000	—	—

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(b) Explain briefly, how a person can claim refund? Also mention its procedure.

Solution:

Normally, any refund of tax to be claimed in the return of income itself. However, Rule 41 lays down that refund claim should be made in Form No. 30 and verified in the prescribed manner. In the following cases, where an otherwise valid refund claim u/s 237 is filed by an assessee after the expiry of the time limit, the Assessing Officer, may admit the refund claim, if the following conditions are satisfied -

- (i) It has been decided that cases where delayed claims of refund are being considered would be taken up for scrutiny.
- (ii) The refund has arisen as a result of excess tax deducted/collected at source and payment of advance tax and the amount of refund does not exceed ₹50,00,000 for one assessment year.
- (iii) The income of the assessee is not assessable in the hands of any other person under any of the provisions of the Act.
- (iv) No interest will be admissible on the belated refund claims.
- (v) No claims under this provision will be entertained where a period of more than 6 assessment years has elapsed.

Board has also decided that: -

- (i) In case of refund does not exceed ₹10,00,000 for any assessment year, the Assessing Officer shall obtain the prior approval of the Commissioner of Income-tax before entertaining a belated refund claim,
- (ii) In case of refund exceeds ₹10,00,000 but does not exceeds ₹50,00,000 for any Assessment Year, the Assessing Officer shall obtain the prior approval of Chief Commissioner of Income Tax or Director General of Income Tax before entertaining a belated refund claim, and
- (iii) Where the refund exceeds ₹50,00,000, approval of the Board is required.

(c) Specify with reason whether following acts can be considered as (I) Tax Management; or (II) Tax Planning; or (III) Tax Evasion; or (IV) Tax Avoidance:

- (i) F deposits ₹70,000 in PPF Account so as to reduce Total Income from ₹3,70,000 to ₹3,00,000.
- (ii) R Ltd. installed an air conditioner costing ₹80,000 at the residence of a director as per terms of his appointment; but treats it as fitted in quality control section in the factory. This is done with the objective to treat it as plant for the purpose of computing depreciation.
- (iii) G Ltd. maintains register of Tax Deduction at Source affected by it to enable timely compliance.
- (iv) J Ltd. issues a credit note for ₹50,000 for brokerage payable to H, who is son of J, managing director of the company. The purpose is to increase his income from ₹1,50,000 to ₹2,00,000 and reduce its income correspondingly.

Solution:

Particulars	The Act is considered as	Reason
(i) F deposits ₹70,000 in PPF Account so as to reduce Total Income from ₹3,70,000 to ₹3,00,000.	Tax Planning	Reducing liability by use of beneficial provisions of law
(ii) R Ltd. installed an air conditioner costing	Tax Evasion	Reducing tax liability

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₹80,000 at the residence of a director as per terms of his appointment; but treats it as fitted in quality control section in the factory. This is done with the objective to treat it as plant for the purpose of computing depreciation.		by dishonest means
(iii) G Ltd. maintains register of Tax Deduction at Source affected by it to enable timely compliance.	Tax Management	Objective is to ensure comply with law
(iv) J Ltd. issues a credit note for ₹50,000 for brokerage payable to H, who is son of J, managing director of the company. The purpose is to increase his income from ₹1,50,000 to ₹2,00,000 and reduce its income correspondingly.	Tax Avoidance	Making use of Loopholes in the Provisions of Law

2.

(a) A, B and C separately own the following properties

	A (₹)	B (₹)	C (₹)
Municipal Value	1,15,000	1,25,000	90,000
Fair Rent	1,27,000	1,20,000	1,50,000
Standard Rent under Rent Control Act	1,35,000	1,15,000	80,000
Annual Rent	1,25,000	1,24,000	1,05,000
Unrealized Rent (all specified conditions are satisfied)	2,000	24,000	3,000
Loss due to vacancy	2,000	2,000	2,000

Calculate the gross annual value for the assessment year 2013-14.

Solution:

	A (₹)	B (₹)	C (₹)
(i) Municipal Value	1,15,000	1,25,000	90,000
(ii) Fair Rental Value or Notional Rental Value	1,27,000	1,20,000	1,50,000
(iii) Higher of (i) and (ii)	1,27,000	1,25,000	1,50,000
(iv) Standard Rent (if applicable)	1,35,000	1,15,000	80,000
(v) Reasonable Expected Rent [Lower of Step (iii) and (iv)]	1,27,000	1,15,000	80,000
(vi) Annual Rent (total rent assuming the property to be let out throughout the previous year)	1,25,000	1,24,000	1,05,000
(vii) Deduct: Unrealized Rent as per Rule 4	2,000	24,000	3,000
(viii) Actual Rent= Step (vi) – (vii)	1,23,000	1,00,000	1,02,000
(ix) Higher of (v) & (viii)	1,27,000	1,15,000	1,02,000
(x) Deduct: Vacancy Allowance [proportionately on the basis of Annual Rent in Step (vi)]	2,000	2,000	2,000
GROSS ANNUAL VALUE	1,25,000	1,13,000	1,00,000

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(b) Rajiv owns two houses – House A and House B. While House A is let out throughout the previous year, House B is used by him for the residential purposes from 1st April, 2012 to 30th November, 2012 and let out on monthly rent of ₹25,000 for remaining part of the year. His business income during the year is ₹8,25,000. Determine the taxable income of Rajiv for the assessment year 2013-14 on the basis of the following information in respect of property income:

	House A (₹)	House B (₹)
Municipal Valuation	2,57,000	3,25,000
Fair Rent	2,50,000	3,75,000
Standard Rent	NA	NA
Composite rent payable by tenants for house and amenities	3,50,000	—
Municipal taxes		
-paid by Rajiv	20,000	60,000
-due but not paid	15,000	—
Repairs(met by the tenant)	16,000	—
Insurance	15,700	18,700
Collection charges	2,500	—
unadjusted unrealized rent of the previous year 2005-06	2,44,000	—

The composite rent of ₹3,50,000 has been fixed on the basis of computation given below:

	(₹)
Rent of the building	2,60,000
Electricity charges	15,000
Water charges	5,000
Lift charges	10,000
Guard and security charges	60,000
Total	3,50,000

For providing the aforesaid services to the tenants of House A, the following expenses are incurred by Rajiv:

	(₹)
Depreciation	11,000
Electricity Bills	18,000
Water Bills	2,900
Lift maintenance	7,000
Depreciation on lift	500
Salary of Guard	30,000
Expenses on providing security	5,500

Solution:

Statement Showing Calculation of Income from House Property

	(₹)	(₹)
Income from House A		
Composite Rent		3,50,000
Less: Charges for providing amenities:		
Electricity charges	15,000	
Water charges	5,000	
Lift charges	10,000	
Guard and security charges	60,000	90,000
Rent received		2,60,000
Municipal Valuation (a)		2,57,000

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Fair Rent (b)		2,50,000
Reasonable expected rent [Higher of (a) and (b)] (c)		2,57,000
Rent received (d)		2,60,000
Higher of (c) and (d)		2,60,000
Less: Loss due to vacancy		Nil
Gross Annual Value		2,60,000
Less: Municipal Tax		20,000
Net Annual Value		2,40,000
Less: Deduction u/s 24		
Standard deduction (30% of Net Annual Value)	72,000	
Interest	Nil	72,000
Income from House A (1)		1,68,000
Income from House B		
Municipal Valuation (a)		3,25,000
Fair Rent (b)		3,75,000
Reasonable expected rent [Higher of (a) and (b)] (c)		3,75,000
Rent received (d)		1,00,000
Higher of (c) and (d)		3,75,000
Less: Loss due to vacancy		Nil
Gross Annual Value		3,75,000
Less: Municipal Tax		60,000
Net Annual Value		3,15,000
Less: Deduction u/s 24		
Standard deduction (30% of Net Annual Value)	94,500	
Interest	Nil	94,500
Income from House B (2)		2,20,500
Income from House Property [(1)+(2)]		3,88,500

Statement Showing Calculation of Net Income of Rajiv for the Assessment Year 2013-14

	(₹)	(₹)	(₹)
Income from House Property			3,88,500
Profits and gains of business or profession			8,25,000
Income from Other Sources:			
Amount collected from tenants of House A for providing different amenities		90,000	
Less: Expenses and depreciation			
Depreciation	11,000		
Electricity Bills	18,000		
Water Bills	2,900		
Lift maintenance	7,000		
Depreciation on lift	500		
Salary of Guard	30,000		
Expenses on providing security	5,500	74,900	15,100
Gross Total Income			12,28,600
Less: Deduction under Chapter VI-A			Nil
Net Income			12,28,600

Note:

(I) Unrealised rent of earlier years is not deductible.

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- (II) Service charges received separately in excess of rent, by owner of building as value of service rendered by him to his tenants should be considered as income from other sources and not as income from house property.
- (III) No deduction is available in respect of insurance and collection charges while computing house property income.

(c) R & Co. Ltd. started two separate industrial undertakings – Unit I and Unit II. Unit I prima facie is eligible for deduction u/s 80IB. For the year ending 31.03.2013, the profit of Unit I was ₹6 Lakhs while Unit II suffered a loss of ₹2 Lakhs.

The Assessing Officer has allowed the deduction u/s 80IB on the net profit of ₹4 Lakhs. Discuss the validity of the order of the Assessing Officer.

Solution:

According to section 80IB deduction is available in respect of the profits or gains derived from the eligible industrial undertaking of the assessee. Section 80IB expressly provides that the deduction under this section shall be calculated on the gains derived from such undertaking.

In view of the above, R & Co. Ltd. is entitled for deduction u/s 80IB at 30% of income derived from Unit I, not on the net income from Unit II.

Hence, the eligible deduction for the assessment year 2013-14 is ₹1,80,000 (i.e. ₹6,00,000 × 30%).

Total Income shall be Net Income from both the undertakings Less Deduction u/s 80IB i.e. ₹4,00,000 Less ₹1,80,000 = ₹2,20,000. Therefore, the action of the Assessing Officer is not valid in law.

3.

(a) Mr. Singh (67) was in the Central Government service. He retired from service in the year 2005. After his retirement, he joined Ambika Ltd. in which the Reserve Bank of India holds 40% equity shares. During the previous year, he gets the following from Ambika Ltd.:

Basic salary - ₹25,000 p.m.; Dearness Allowance - 10% of basic salary (50% of which form part of retirement benefit); overtime allowance - ₹1,000 p.m.; helper allowance - ₹1,500 p.m. (he actually spent ₹1,200 p.m.); medical bills reimbursement - ₹60,000 (out of which ₹30,000 is in respect of treatment in a Government's hospital); free telephone at residence - ₹6,000; free gas and electricity for personal use - ₹24,000; free lunch in office - ₹15,000 (amount paid directly to canteen @ ₹50 per day for 300 days); interest free loan for house ₹5,00,000 for 5 years (SBI lending rate is 10%); he is entitled for 24 leaves for each year which he has encashed during the year - ₹24,000; mediclaim for him - ₹10,300; mediclaim for his son employed in Saha Industries - ₹6,180; leave travel concession - ₹50,000 (no journey has undertaken).

He has been paid house rent allowance of ₹5,000 per month up to 31st December, 2012 (rent paid at Delhi ₹5,000 per month) after that, he has been provided a rent-free furnished house at Delhi whose lease rent is ₹10,000 p.m. (rent of furniture provided - ₹2,000 p.m.). Further, Ambika Ltd. bears ₹7,000 for repairs of the house.

Income of Mr. Singh from other sources is ₹5,50,000 (Including Government pension of ₹2,40,000).

Find out Income Tax liability of Mr. Singh for the assessment year 2013-14 on the assumption that Mr. Singh contributes ₹5,000 and ₹1,000 per month towards recognized provident fund and public provident fund respectively.

Solution:

Computation of Taxable Income

	(₹)	(₹)
Basic salary (₹25,000 × 12)		3,00,000
Dearness Allowance (10% of basic salary)		30,000
Overtime Allowance (₹1,000 × 12)		12,000

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Helper Allowance $[(₹1,500 - ₹1,200) \times 12]$		3,600
Medical bills reimbursement	60,000	
Less: Reimbursement of Government hospital bills	30,000	
	30,000	
Less: Amount not taxable	15,000	15,000
Free telephone at residence		Nil
Free gas and electricity		24,000
Free lunch (not taxable)		Nil
Interest free loan $(₹5,00,000 \times 10\%)$		50,000
Earned leave encashment		24,000
Medicclaim for Mr. Singh		Nil
Medicclaim for his son		6,180
Leave travel concession		50,000
House Rent Allowance [W. N. I]		23,625
Rent free furnished house [W. N. II]		82,200
Pension from Government		2,40,000
Gross Salary		8,60,605
Less: Deduction u/s 16		Nil
Income from Salary		8,60,605
Income from Other Sources		3,10,000
Gross Total Income		11,70,605
Less: Deduction under Chapter VI-A:		
Section 80C		72,000
Net Income		10,98,605

Computation of Tax Liability

	(₹)	(₹)
Tax		1,54,582
Add: Surcharge (Not Applicable)		Nil
Tax and Surcharge		1,54,582
Add: Education cess		3,092
Add: Secondary and higher education cess		1,546
Tax Payable		1,59,220

Working Notes:

I. Statement Showing Computation of House Rent Allowance

	(₹)	(₹)
Actual amount received $(5,000 \times 9)$		45,000
Less: Exemption u/s 10(13A) Rule 2A		
Least of the followings:		
(a) Actual amount received	45,000	
(b) 50% of salary [i.e. $50\% \times (₹3,00,000 + ₹30,000 \times 50\%) \times 9/12$]	1,18,125	
(c) Rent paid – 10% of Salary [$5,000 \times 9 - 10\% \text{ of } (₹3,00,000 + ₹30,000 \times 50\%) \times 9/12$]	21,375	21,375
		23,625

II. Statement Showing Computation of Taxable amount of Rent Free Furnished Accommodation

	(₹)	(₹)
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Basic salary (₹25,000 × 10)		2,50,000
Dearness Allowance (10% of basic salary)		25,000
Overtime Allowance (₹1,000 × 10)		10,000
Helper Allowance [(₹1,500 - ₹1,200) × 10]		3,000
Earned leave encashment (for 10 months)		20,000
Pension from Government (for 10 months)		2,00,000
Salary for 10 months		5,08,000
Lease rent of 10 months		1,00,000
Value of unfurnished house:		
15% of Salary for 10 months		76,200
Lease Rent for 10 months		1,00,000
Whichever is lower		76,200
Add: Rent of furniture		6,000
Value of furnished accommodation		82,200

(b) Mr. Thakur, a foreign technician is employed with an Indian company. His contract of service was approved by the Government. He was in receipt of bonus from the said Company where he is working. The Assessing Officer subjected the amount to tax on the ground that bonus receipt falls outside the purview of the contract of service. Is the Assessing Officer justified?

Solution:

U/s 9(1)(ii) salary earned in India is deemed to accrue or arise in India and is taxable in India. The salary and bonus paid to a foreign technician for services rendered in India is taxable in India and the same is not entitled for any exemption from the Assessment Year 2008-09 onwards. Hence, the assessing Officer can levy tax on the amount of bonus received.

(c) “Provisions of Alternate Minimum Taxation shall apply to every non-corporate assessee” – State the correctness of the given statement? Give reason with your answer.

Solution:

The provisions of Alternate Minimum Tax shall apply to a non-corporate assessee who has claimed any deduction under:

- (i) under sections 80-IA to 80RRB other than section 80P; or
- (ii) section 10AA

Again The provisions of Alternate Minimum Tax under Chapter XII-BA shall not apply to-

- (i) an Individual or
 - (ii) a Hindu Undivided Family or
 - (iii) an Association of Persons or a Body of Individuals (whether incorporated or not) or
 - (iv) an Artificial Juridical Person referred to in section 2(31)(vii),
- if the adjusted total income of such person does not exceed ₹20,00,000

Hence, the given statement is not correct.

4.

(a) A Ltd., an Indian company, is engaged in the business of production of minerals. During the previous year 2011-12, it starts commercial exploration of a new mine at Jharkhand. Compute Net Income for the assessment year 2012-13 and 2013-14 from the given information –

	Previous Year 2011-12 ₹	Previous Year 2012-13 ₹

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Income from mining before deduction u/s 35E		
— from old mining	50,000	3,45,000
— from new mining	30,000	80,000
Other business income	4,10,000	4,20,000

Qualifying Expenditure

	₹
Expenses for the purpose of exploring and locating mineral incurred up to previous year 2006-07	7,50,000
Expenses for the purpose of exploring and locating mineral incurred from previous year 2007-08 to 2011-12	10,44,000
Acquisition of site on 20 July, 2007	5,40,000
Purchase of plant, machinery and building on 28 th August, 2008	5,90,000

The expenses for the purpose of exploring and locating mineral incurred from previous year 2007-08 to 2011-12 includes ₹1,44,000 which is met by the Government.

Solution:

Computation of Qualifying Expenditure

	₹
Expenses for the purpose of exploring and locating mineral incurred up to previous year 2006-07 (Not allowed)	Nil
Expenses for the purpose of exploring and locating mineral incurred from previous year 2007-08 to 2011-12 (₹10,44,000 - ₹1,44,000)	9,00,000
Acquisition of site on 20 July, 2007 (Not allowed)	Nil
Purchase of plant, machinery and building on 28 th August, 2008 (Deduction not available)	Nil
Total Qualifying Expenditure	9,00,000
Amount deductible during 10 years (₹9,00,000 ÷ 10)	90,000

Computation of Net Income for the assessment year 2012-13

	₹
Income from mining (₹50,000 + ₹30,000)	80,000
Less: Deduction u/s 35E (i.e. ₹80,000 or ₹90,000, whichever is less)	80,000
	Nil
Other business income	4,10,000
Net Income	4,10,000

Computation of Net Income for the assessment year 2013-14

	₹
Income from mining (₹3,45,000 + ₹80,000)	4,25,000
Less: Deduction u/s 35E [i.e. ₹90,000 + ₹10,000 (unabsorbed last year) or ₹4,25,000, whichever is less]	1,00,000
	3,25,000
Other business income	4,20,000
Net Income	7,45,000

(b) Net Profit of W Ltd., an Indian company, as per Profit and Loss A/c for the year ended 31st March, 2013 is ₹9,37,000. Advertisement expenditure debited to the Profit and Loss A/c is ₹3,00,000 out of which ₹1,30,000 is in respect of advertisement which is appeared in a magazine owned by a political party. Determine the Net Income of the company.

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Will your answer be different if, in the above case, the assessee is W Inc., a foreign company?

Solution:

Computation of Net Income of W Ltd., an Indian company, for the assessment year 2013-14

	₹
Net Profit as per Profit and Loss A/c	9,37,000
Add: Advertisement expenditure not deductible by virtue of section 37(2B) (being advertisement expenditure in a magazine owned by a political party)	1,30,000
Business Income	10,67,000
Other Income	Nil
Gross Total Income	10,67,000
Less: Deduction under Chapter VI-A	
Section 80GGB (in the case of an Indian Company advertisement expenditure paid to political party is treated as "contribution" to the political party and deduction u/s 80GGB)	1,30,000
Net Income	9,37,000

Computation of Net Income of W Inc., a foreign company, for the assessment year 2013-14

	₹
Net Profit as per Profit and Loss A/c	9,37,000
Add: Advertisement expenditure not deductible by virtue of section 37(2B) (being advertisement expenditure in a magazine owned by a political party)	1,30,000
Business Income	10,67,000
Other Income	Nil
Gross Total Income	10,67,000
Less: Deduction under Chapter VI-A	
Section 80GGB (No deduction available for any assessee other than an Indian company)	Nil
Net Income	10,67,000

(c) ABC LLP has income of ₹14,00,000 under the head "Profit and Gains of Business or Profession". One of its businesses is eligible for deduction @100% of profits u/s 80IB for the assessment year 2013-14. The profit from such business included in the business income is ₹7,00,000. Compute the tax payable by the LLP assuming it has no other income during the previous year 2012-13.

Solution:

Computation of tax payable under Income Tax of ABC LLP for the A.Y. 2013-14 relating to the P.Y. 2012-13

Particulars	Amount (₹)
Profit and Gains from Business or Profession	14,00,000
Less: Deduction u/s 80IB	7,00,000
Total Income	7,00,000
Tax Payable (₹7,00,000 × 30%)	2,10,000
Add: Education Cess @ 2%	4,200
Add: Secondary and Higher Education Cess @ 1%	2,100
Total Tax Payable	2,16,300

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Computation of Alternate Minimum Tax (AMT) of ABC LLP for the A.Y. 2013-14 relating to the P.Y. 2012-13

Particulars	Amount (₹)
Total Income as per the provisions of Income Tax Act, 1961	7,00,000
Add: Deduction u/s 80IB	7,00,000
Adjusted Total Income	14,00,000
Alternate Minimum Tax Payable (₹14,00,000 × 18.5%)	2,59,000
Add: Education Cess @ 2%	5,180
Add: Secondary and Higher Education Cess @ 1%	2,590
Total Tax Payable	2,66,770

- (i) Since the Income Tax payable as per the provision of the Income Tax Act is less than the Alternate Minimum Tax, the Adjusted Total Income of ₹14,00,000 would be deemed to be the Total Income of the LLP and the LLP would be liable to pay tax @18.5% thereof.
- (ii) The amount of tax payable by ABC LLP for the A.Y. 2013-14 would therefore be ₹2,66,770.
- (iii) ABC LLP is eligible for credit to the extent of ₹50,470 (i.e. ₹2,66,770 – ₹2,16,300) to be set off in the year in which tax on Total Income computed under the regular provision of the Act exceeds the Alternate Minimum Tax. The credit shall be allowed to be carried forward up to the tenth assessment year immediately succeeding the assessment year for which such credit is allowable.

5.

(a) Ashim acquired a building on May 12, 2001 for ₹27 Lakhs. In 2004, He entered into negotiation with a prospective buyer, who gave him advance money of ₹3 Lakhs at that time. However, the negotiations failed and Ashim forfeited the advance money. Subsequently, he actually sold the building in August 2012 for ₹50 Lakhs. Calculate the taxable capital gains on the sale of the building.

Solution:

Computation of Taxable Capital Gains		
Particulars	₹	₹
Sales Consideration		50,00,000
Actual Cost	27,00,000	
Less: Earnest money forfeited	3,00,000	
	24,00,000	
Less: Indexed Cost of Acquisition [24,00,000 X 852/426]		48,00,000
Long Term Capital Gain		2,00,000

(b) A jeweller converts his ancestral gold ornaments into the stock-in-trade of his jewellery business on 01.01.2003. The ornaments are actually sold on 27.01.2013 for ₹100 Lakhs. The market value of these ornaments was ₹10 Lakhs on 01.04.1981 and ₹50 Lakhs on 01.01.2003. State the tax implications of the above transactions.

Solution:

This is a case of conversion of personal asset into stock in trade. The capital gain arises on the date of conversion i.e. 01.01.2003 but date of liability will be 27.01.2013, when the stock was in fact sold. Being ancestral property, the fair market value of ₹10 Lakhs as on 01.04.1981 will be the cost of acquisition.

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On 01.01.2003(date of conversion), LTCG will be ₹5.30 Lakhs being the difference of market value on the date of conversion and the cost of acquisition (i.e. ₹50 Lakhs - ₹10 Lakhs X 447/100)
On 27.01.2013, when the ornaments were actually sold for ₹100 Lakhs, ₹50 Lakhs (i.e. ₹100 Lakhs - ₹50 Lakhs) will be treated as business profit

Hence, ₹50 Lakhs will be his business profit and ₹5.30 Lakhs will be his LTCG for the A.Y. 2013-14.

(c) Binay owns a house property. It is used by him throughout the previous year 2012-13 for his and his family members' residence. Municipal value of the property is ₹1,76,000, whereas fair rent is ₹1,80,000 and standard rent is ₹1,60,000. The following expenses are incurred by Binay—repairs: ₹20,000, municipal tax: ₹16,000, insurance: ₹2,000; interest on capital borrowed to construct the property (the property was constructed within 3 years): ₹1,40,000; interest on capital borrowed by mortgaging the property for his daughter's marriage: ₹20,000 (in either case capital is borrowed on April 1, 2005). Income of Binay from business is ₹7,40,000. Find out the net income of Binay for the assessment year 2013-14.

Solution:

Particulars	₹
Gross Annual Value	Nil
Less: Municipal tax	Nil
Net Annual Value	Nil
Less: Interest on borrowed capital (maximum: ₹1,50,000 or actual interest paid whichever is lower)	1,40,000
Income from House Property	(1,40,000)
Business Income	7,40,000
Net Income	6,00,000

Note: interest on capital borrowed by mortgaging the property for his daughter's marriage is not allowed as deduction.

6.

(a) Is e-filing of return mandatory? State the assessee's for whom e-filing of returns is mandatory?

Solution:

CBDT has vide notification No. 34/2013 dated 01.05.2013 has made it mandatory for the following category of the Assessee to file their Income Tax Return Online from A.Y. 2013-14:-

- Every person (not being a company or a person filing return in ITR 7) having total income exceeding ₹5,00,000.
- an individual or a Hindu Undivided Family, being a resident, having assets (including financial interest in any entity) located outside India or signing authority in any account located outside India and required to furnish the return in Form ITR-2 or ITR-3 or ITR-4, as the case may be.
- Every person claiming tax relief under Section 90, 90A or 91.
- Those who are required to get their Account audited under Section 44AB, 92E, 115JB.
- A company required to furnish the return in Form ITR-6.

However, as per instruction of ITR 7, from assessment year 2013-14 onwards in case an assessee who is required to furnish a report of audit under section 10(23C)(iv), 10(23C)(v), 10(23C)(vi), 10(23C)(via), 10A, 12A(1)(b), 44AB, 80-IA, 80-IB, 80-IC, 80-ID, 80JJAA, 80LA, 92E or 115JB he shall file the report electronically on or before the date of filing the return of income.

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(b) Determine residential status for the assessment year 2013-14, of Virat, a Nepal Citizen who leaves India for employment in Canada on 30th June, 2012. He has been stayed in India since 1995.

Solution:

Virat was in India for 91 days in 2012-13 (April 2012: 30 days. May 2012: 31 days; and June 2012: 30 days).

Virat will not be covered by the exception U/s 6(1) as he is not an Indian citizen. He satisfies the second basic condition u/s 6(1) (i.e. 365 days stays in the preceding four years and 60 days stay during 2012-13). Since he also satisfies both the additional conditions (i.e. 730 days stay in 7 preceding years and 2 years resident in preceding 10 years), he will be a resident and ordinary resident in India.

(c) Shamim provides you the following information:

Particulars	₹
(i) Salary accrued and received in India	40,000
(ii) Agricultural Income from Tea Gardens in Sri Lanka received in India	66,000
(iii) Profit from hotel business in London	1,60,000
(iv) Dividends declared in London received in India	65,000
(v) Gain from transfer of capital asset in India	35,000
(vi) Interest on Debentures of a company in Canada received in India	20,000
(vii) Royalty received in Paris from a resident in India for technical services provided for a business in Paris	25,000
(viii) Interest received in UK from Mr. Robert, a non-resident, on loan provided to him for business in India	5,000
(ix) Fees from an Indian company carrying on business in the UK for technical services rendered in London, directly deposited in his Bank Account in India	35,000

Compute the Gross Total Income of Shamim for the relevant previous year 2012-13, if he is (i) Ordinarily Resident, (ii) Not Ordinarily Resident, (iii) Non Resident.

Solution:

According to Section 5, any income received or deemed to be received or accrued or deemed to be accrued in India is taxable in the hands of the assessee irrespective of the residential status of the assessee.

Where, India means-

- the territory of the Union as referred to in clauses (2) and (3) of Article 1 of the Constitution i.e. the States and Union Territories;
- its territorial waters, continental shelf, exclusive economic zone or any other maritime zone as defined in the Territorial Waters, Continental Shelf, Exclusive Economic Zone and other Maritime Zones Act, 1976;
- the seabed and the subsoil underlying the territorial waters;
- the air space above its territory and territorial waters; and
- the installations, structures and vessels located in the continental shelf of India and the exclusive economic zone of India, for the purposes of prospecting or extraction or production of mineral oil and natural gas and supply thereof.

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Computation of Gross Total Income of Shamim for the Previous Year 2012-2013

Particulars	ROR	RNOR	NR
(i) Salary accrued and received in India	40,000	40,000	40,000
(ii) Agricultural Income from Tea Gardens in Sri Lanka received in India	66,000	66,000	66,000
(iii) Profit from hotel business in London	1,60,000	-	-
(iv) Dividends declared in London received in India	65,000	65,000	65,000
(v) Gain from transfer of a capital asset in India deemed to accrue or arise in India	35,000	35,000	35,000
(vi) Interest on debentures of a company in Canada but received in India	20,000	20,000	20,000
(vii) Royalty received in Paris from a resident in India for technical services provided for a business in Paris	25,000	-	-
(viii) Interest received in UK from Mr. Robert, a non-resident, on loan provided to him for business in India	5,000	5,000	5,000
(ix) Fees from an Indian company, carrying on business in UK for technical services rendered in London, directly deposited in his Bank Account in India	35,000	35,000	35,000
Gross Total Income	4,51,000	2,66,000	2,66,000

7.

(a) W Ltd. incurred expenditure for acquiring know-how on 15th December, 2012. Is the deduction u/s 35AB available? Justify.

Solution:

As the expenditure on know-how is incurred after 31st March, 1998, deduction u/s 35AB is not available. However, W Ltd. can claim depreciation u/s 32 against this amount.

(b) The Accounts of a Firm are subject to Tax Audit u/s 44AB. A working partner of the firm is entitled to receive a fixed remuneration of ₹15,000 per month. He files his return of income on 28.09.2013 for the assessment year 2013-14. The Assessing Officer charges interest u/s 234A for delay in the filing of return. Discuss the validity of the order of the Assessing Office.

Solution:

According to section 139(1) the due date of filing the return of income in case of a working partner of a Firm, which is subject to tax audit u/s 44AB, is 30th September of the relevant assessment year. So, the working partner in the given case has filed his return of income within the due date and he is not liable to pay interest u/s 234A. Therefore, the action of the Assessing Officer is not valid in law.

(c) Can the Authority giving approval under the Act withdraw even though no such power is specifically vested with him under the Act?

Solution:

Section 293C provides that Central Government, Board or Income Tax Authority who is vested with the powers to grant approval shall also have power to withdraw approval at any time after providing an opportunity of being heard to the assessee, even though the Act does not confer on him the specific right to withdraw the approval.

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(d) Assessing Officer omitted to grant to the assessee interest u/s 244A on refund found to be payable in an order passed pursuant to appellate order. Assessee is seeking grant of said interest. Discuss the validity of the above proposal to rectify u/s 154.

Solution:

It is mandatory to grant interest u/s 244A on refund, the omission of which is a mistake of law apparent from the record. Hence, the order can be rectified u/s 154.

(e) Z Ltd., carrying on business of a five star hotel, claims that the building in which the business is carried on has been specifically designed and equipped and therefore must be treated as "Plant" for deduction of depreciation u/s 32. Will the claim be admissible? Justify your answer.

Solution:

According to section 43(3), "Plant" specifically excludes Tea Bushes or Livestock or Buildings or Furniture and Fittings. Hence, Hotel Building cannot be treated as "Plant" for the purposes of depreciation.

(f) An amount of ₹10 Lakhs was paid on 17.03.2013 to Jugilal, father of Aman, by the Government as compensation to the grieved family whose only son Aman lost his life in Mumbai local train serial bomb blast. Is the amount of compensation received chargeable to tax in assessment year 2013-14?

Solution:

Section 10(10BC) provides that any compensation received on account of disaster by an Individual or his legal heir from the Central or State Government or Local Authority is exempt. Hence, the compensation received by Jugilal from the Government is exempt from tax.

(g) A Plantation company, holding several acres of land, sold trees of spontaneous growth. The Assessing officer is of the opinion that there arise capital gains. Discuss

Solution:

Sale proceeds of spontaneous growth will not result in capital gains, as they do not bring in any profit or gain [Suman Tea & Plywood Industries Pvt. Ltd (1997) 226 ITR 34 (SC)].

(h) Who shall sign and verify the return of income of a Limited Liability Partnership?

Solution:

As per section 140, for LLP the return should be signed by the designated partner. Where, however, there is no designated partner as such, return of income can be signed by any partner except by minor.

(i) Is it mandatory for a Company to pay advance tax on the Book Profit?

Solution:

The Book Profit computed u/s 115JB shall be deemed to be the Total Income of the Assessee for the purpose of payment of any tax under the Income Tax Act, 1961, if the Total Income computed as per Income Tax Act is less than the Book Profit. In that case the company has to pay advance tax on its Book Profit. Where the company fails to pay advance tax on such book profits, then it is liable to pay interest u/s 234B and 234C. [Circular No.13/2001] [Kotak Mahindra Finance Ltd.265 ITR 114 (Bom)]

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(j) What will be the residential status of Z Ltd. an Indian company managed from New York?

Solution:

Indian company will always be Resident of India even if it is managed from outside India. Hence, the status of Z Ltd. is Resident.

(k) Samir received ₹26,910 as interest net of TDS @ 10.3% on debentures of Q Ltd. worth ₹3,00,000 held by him. Calculate the interest income and the amount of TDS @ 10.3% that can be claimed.

Solution:

Since interest amount is net of TDS i.e. 89.7% or $[100-10.3\%]$, it will have to be grossed up and the interest Income will be ₹30,000 [i.e. $₹26,910 / 89.7\%$] and TDS to be claimed $₹30,000 - ₹26,910 = ₹3,090$

(l) Mrs. Sharma receives ₹78,000 as yearly pension after the death of her husband. She pays ₹1,000 per month to Amar to collect it from the office of the employer. Calculate the net taxable pension of Mrs. Sharma.

Solution:

	₹
Pension amount	78,000
Less: Lower of the following :	
1/3 rd of the pension (i.e. $₹78,000 \times 1/3 = ₹26,000$) or ₹15,000 whichever is lower	15,000
Taxable Pension	63,000

The expenses occurred for collection of family pension to the extent of ₹12,000 shall not be allowable as deduction since the standard deduction of 1/3 rd of family pension or ₹15,000 is to cover such expenses.

(m) Is tax planning necessary? Does it have any effect on the rate of tax?

Solution:

The tax paid is an addition to the cost. Just as every businessman tries to maximize his profit by reducing the cost, he should also arrange his affairs in such a way, that he pays the least amount of tax. This, however, should be done within the four corners of law and there should be no element of fraud in it.

Tax planning has effect on the rate of tax. As dispersal of income over different taxable entities, slab rate can be reduced.

8.

(a) Do you think notice issued u/s 142(1) and notice u/s 143(2) mean same? Justify your answer.

Solution:

Notice issued u/s 142(1) is different from that of notice issued u/s 143(2) in the following ways:

Notice u/s 142(1)	Notice u/s 143(2)
It is a notice to file return of income or produce accounts or documents or furnish information as the Assessing Office may require	It is a notice for making assessment u/s 143(3)
No assessment is possible by issue of this notice	Assessment can be made only if the notice u/s 143(2) is served on the assessee.

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No time limit is prescribed for service of this notice	Time limit of 6 months from the end of relevant assessment year prescribed for service of notice
Approval of Joint Commissioner is necessary if statement of all assets and liabilities not included in accounts is required	No approval required
Books of accounts can be called for, for a maximum period of 3 years prior to the previous year	No such restriction is there in this case
Notice can be served even if no return of income is furnished	Notice can be served only if the return of income has been furnished

(b) Explain the tax treatment of income from Deep Discount Bonds (DDBs).

Solution:

Deep discount bonds as clarified vide Circular No.2/2002 as follows:

- I. Income based on market value
 - (i) Income treated as interest for investors
 - (ii) Income treated as business income for traders
- II.
 - (i) For original subscribers, Income = difference between market value on 31st March of the previous year and 1st April of the previous year
 - (ii) For subsequent purchases, income = difference between market value on 31st March of the previous year and cost of purchase of the bond
- III. If there is a transfer before maturity:
 - (i) For the Investor, Short term Capital Gains = Sale Price less Cost of Bond;
 - (ii) For Traders, Business Income = Sale price less cost of bond.
- IV. Cost of bond = Cost of acquisition + Income already taxed upto the date of transfer.
- V. If there is a redemption on maturity:
 - (i) For the Investor, Interest Income = Redemption Price less market value as on the last valuation date, immediately preceding the maturity date.
In case of a trader, this interest income would be construed as Business Income.
 - (ii) For subsequent purchasers, Interest Income = Redemption price less cost of the bond to such purchaser.
In case of a trader, this interest income would be construed as Business Income.
Where, Cost of bond = cost of acquisition + income already taxed by the bond holder up to the date of redemption

(c) Dipika purchased jewellery worth ₹2,00,000 on 17.10.1985. On 17.11.1990, she further purchased jewellery worth ₹3,00,000. All the jewellery was sold by her on 16.09.2012. The jewellery purchased on 17.10.1985 was sold for ₹18 Lakhs and that purchased on 17.11.1990 was sold for ₹27 Lakhs.

On 26.09.2012, she deposited ₹42 Lakhs in Capital Gains Scheme Account.

On 21.01.2013, withdrawing from the Deposit Account, she utilised ₹40 Lakhs for purchase of a residential house property in Kolkata.

On the date of transfer she owns only one residential house.

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Solution:

Computation of Capital Gains of Dipika for the A.Y. 2013-14

	₹
(a) On transfer of jewellery purchased on 17.10.1985	
Consideration for transfer	18,00,000
Less : Indexed Cost of Acquisition	
$2,00,000 \times \frac{852}{133}$	12,81,203
Long-term Capital Gains	5,18,797
(b) On transfer of jewellery purchased on 17.11.1990	
Consideration for transfer	27,00,000
Less : Indexed Cost of Acquisition	
$3,00,000 \times \frac{852}{182}$	14,04,396
Long-term Capital Gains	12,95,604

In order to avail the maximum benefit u/s 54F, the exemption should be computed as follows:

	₹
Total long-term Capital Gain (5,18,797 + 12,95,604)	18,14,401
Less : Exemption u/s 54F $\left[\frac{\text{Cost of New House} + \text{Amount Deposited}}{\text{Net Consideration}} \times \text{LTCG} \right]$	
$= \frac{42,00,000}{45,00,000} \times 18,14,401$	16,93,441
Taxable Long-term Capital Gains	1,20,960

Note:

- I. In this case, Dipika has not fully utilised the deposit account for acquiring a residential house property. Out of ₹42 Lakhs deposited for acquiring the house, it is utilised to the extent ₹ 40 Lakhs.

Tax treatment of unutilised amount, will be as follows:-

	₹
(a) Unutilised amount	2,00,000
(b) Net sale consideration	45,00,000
(c) Original Capital Gain	18,14,401
(d) Notional Long-term Capital Gain $\left[\frac{2,00,000}{45,00,000} \times 18,14,401 \right]$	80,640
(e) Effective exemption u/s 54F	16,12,801
[₹16,93,441 – ₹80,640]	

₹80,640 will be chargeable to tax as Long-term Capital Gain after expiry of 3 years from the date of transfer of jewellery. Consequently it will be taxable for the assessment year 2016-17.

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- II. The unutilised amount of ₹ 2 Lakhs can be utilised by Dipika at any time after 16.09.2012.
III. If Dipika sells this new house property before 21.01.2016, then ₹16,93,441 (exemption u/s 54F) will be to tax as Long-term Capital Gain of the year in which the house is sold.

9.

(a) Subir presents his financial data as follows for the previous year 2012-13

- (i) Business income ₹8,90,000
(ii) Capital Gains ₹3,30,000
(iii) Payment of medical insurance premium on own life ₹10,000
(iv) He pays ₹50,000 to GIC for maintenance of his severely disabled son under an approved scheme.
(v) He has borrowed ₹5,00,000 as educational loan for his younger son who pursues MBA and pays 10% interest on the loan.
(vi) Subir himself is severely disabled.
Determine the income of Subir for the assessment year 2013-14.

Solution:

Computation of Total Income of Subir for the assessment year 2013-14

	₹	₹
Business Income		8,90,000
Capital gains		3,30,000
Gross Total Income		12,20,000
Deductions under Chapter VI-A		
80D: Mediclaim	10,000	
80DD: Maintenance of dependent with severe disability	1,00,000	
80E: Interest on study loan	50,000	
80U: Severe disability	1,00,000	
Total Deductions under Chapter VI-A		2,60,000
Total Income		9,60,000

Note: ₹1,00,000 will be allowed as deduction u/s 80DD irrespective of the expenditure incurred or amount deposited.

(b) Evergreen Ltd. is engaged in the business of hotel, one of which is located in Delhi having a World Heritage Site. Discuss taxability of profits.

Solution:

According to 80-ID, a undertaking engaged in the business of hotels located in specified district having a world heritage site (w.e.f. assessment year 2009-10), would be eligible for deduction @100% of profits for the first 5 years, provided, the date of commencement is on or after 01.04.2008 but up to 31.03.2013.

Hotel means a hotel of two-star, three-star or four-star category as classified by the Central Government. Specified area means the National Capital Territory of Delhi and the districts of Faridabad, Gurgaon, Gautam Budh Nagar and Ghaziabad.

Hence, if the hotel of Evergreen Ltd. falls within the definition of hotel as per the Act and if it is commenced within the period starting from 01.04.2008 to 31.03.2013, the company is eligible for deduction @100% of profits for the first 5 years u/s 80-ID.

(c) Do you think the terms "application of income" and "diversion of income" have same meaning? Justify your answer.

Solution:

The terms "application of income" and "diversion of income" have different meanings.

Application of Income is an obligation to apply income, which has accrued or has arisen or has been received amounts to merely the apportionment of income. Therefore the essentials of the concept of application of income under the provisions of the Income Tax Act are:

- (i) Income accrues to the assessee
- (ii) Income reaches the assessee
- (iii) Income is applied to discharge an obligation, whether self-imposed or gratuitous.

Diversion of Income is an obligation to apply the income in a particular way before it is received by the assessee or before it has arisen or accrued to the assessee results in diversion of income. The source is charged with an overriding title, which diverts the income. Therefore, the essentials are the following:

- (i) Income is diverted at source,
- (ii) There is an overriding charge or title for such diversion, and
- (iii) The charge / obligation is on the source of income and not on the receiver.

Examples of diversion by overriding title are -

- (i) Right of maintenance of dependants or of coparceners on partition
- (ii) Right under a statutory provision
- (iii) A charge created by a decree of a Court of law

10.

(a) Deepak avails the benefit of LTC and travelled by air (economy class) on a holiday in India on 25th December, 2012 along with his wife and three children consisting of daughter aged 5 years and twin sons of 2 years age. Total cost of tickets reimbursed by his employer was ₹80,000 (₹50,000 for two adults and ₹30,000 for three children). State with reason the amount which can be claimed by Deepak out of reimbursement as not subject to tax? Will your answer be different where among his three children the twins are of 5 years of age and the age of the daughter was of 2 years old?

Solution:

The LTC exemption is available only for two children of an individual born after 01.10.1998. In reckoning this limit of two children, children born out of multiple births after the first birth will be treated as one child only.

First daughter and then twin sons – The exemption shall apply to all the three children as the twins will be considered as one child. Hence, ₹80,000 can be claimed as exemption.

First twin sons and then daughter – The exemption will apply to the twin sons who are considered as two children and not to the daughter. Hence, only ₹70,000 can be claimed as exemption.

(b) LLM Ltd. under its ESOP scheme allotted 400 equity shares of its Finance Manager, Mr. Sharma on 17th June, 2012, when he exercised his option. The Option was granted on 15th February 2011 and shares vested with him on 15th February, 2012. The company's shares are quoted in the recognized stock exchange where the Opening Price and Closing Price on the exercise date were ₹300 and ₹310 respectively. The Company recovered ₹100 per share from Mr. Sharma. Compute the taxable value of the perquisite. What is the cost of acquisition of such shares?

Solution:

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As per Section 17(2), any specified security or Sweat Equity Shares allotted free of cost or at concessional rates to employees is taxable as perquisite in the hands of the employee w.e.f. Assessment Year 2010-11.

Taxable Value of perquisite = Fair Market Value on the date of exercise of the option less amount recovered from employee.

Calculation of Value of Perquisite

Particulars	Amount (₹)
Opening Price on the date of Exercise	300
Opening Price on the date of Exercise	310
Fair Market Value on the date exercise $[(300+310)/2]$	305
Fair Market Value of the shares allotted $[400 \times 305]$	1,22,000
Amount received from Mr. Sharma $[400 \times 100]$	40,000
Value of Perquisite	82,000

Cost of acquisition of the shares allotted:

As per Section 49(2AB), Cost of Acquisition of shares so allotted for the employee shall be the value considered for valuing such shares for the purpose of perquisite. Therefore, ₹305 shall be considered as the Cost of Acquisition of such shares.

(c) **Rajiv is a person carrying on profession as Film Artist. His gross receipts from profession are as follows:**

Financial Year	Amount Received (₹)
2011-12	1,95,000
2010-11	1,81,000
2009-10	1,25,000

What is his obligation regarding maintenance of books of accounts for the assessment year 2013-14 u/s 44AA?

Solution:

Section 44AA requires every person carrying on any profession, notified by the Board of the Official Gazette (in addition to the professions already specified) to maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of the Income-tax Act. The CBDT has notified the profession of film artists as one such profession (S.O. No.17E/12-1-77).

However, under the proviso to Sub-rule (1), nothing contained therein shall apply in the case of a person, if his gross receipts do not exceed ₹1,50,000/- in any one of the three years, immediately preceding the Previous Year.

Therefore, Rajiv being a specified person is not required to maintain books of accounts for the assessment year 2013-14 relating to the previous year 2012-13, since his gross receipt have not exceeded ₹1,50,000 in each of the 3 preceding financial year.

(d) **“If the Audit Report obtained u/s 44AB is not filed along with the Return of Income, then the Assessing Officer may treat the return as Defective Return and impose penalty” – State the exception of the above statement.**

Solution:

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Section 271B confers discretionary power on the Assessing Officer to impose penalty for non-compliance of section 44AB. If reasonable cause is shown, the Assessing Officer can condone the delay and relieve the assessee from payment of penalty.

Following are considered as "Reasonable Cause":

- (i) Resignation of Tax Auditor,
- (ii) Bonafide interpretation of the term "Turnover" based on expert advice,
- (iii) Death or physical inability of the Partner-in-Charge of the accounts,
- (iv) Loss of books of accounts by theft, fire, etc. beyond the control of the assessee
- (v) Labour problems such as Strike, Lock-out, for a long period.
- (vi) Non-availability of accounts on account of seizure,
- (vii) Natural calamities, commotion, etc.

Penalty u/s 271B cannot be imposed for the subsequent years, where books of accounts for preceding assessment years were not up to date and hence it is not possible to get the books audited.

11.

(a) AK Ltd. issued 10% Debentures and raised ₹100 Lakhs. The debentures are redeemable after 5 years at a premium of 110%. The company wants to provide ₹2 Lakhs for meeting the premium on redemption of debentures and claimed the same as revenue expenditure. Is it a permissible deduction?

Solution:

Premium payable on redemption of debentures is allowed as deduction over the period of debentures.

In the given case, it is assumed that total redemption value is 110% of face value and premium is 10% of face value. Hence, Redemption Value = ₹100 Lakhs × 110% = ₹110 Lakhs. Therefore, the premium = ₹110 Lakhs - ₹100 Lakhs = ₹10 Lakhs.

Pro-rata Premium allowed over the period of debentures = ₹10 Lakhs / 5 years = ₹2 Lakhs

Hence, the provision for premium on redemption of ₹2 Lakhs will be allowable as deduction.

(b) Discuss the admissibility of the following expenditure with reasons:

- (i) Provisions made for gratuity as per actuarial valuation ₹1,50,000.
- (ii) Senior advocate who conducted the Income Tax proceedings before the Income Tax Authorities was paid ₹25,000.
- (iii) Travelling expenses include ₹45,000 incurred by a Director while travelling abroad to negotiate the purchase of plant and machinery.
- (iv) A sum of ₹25,000 was provided towards Sales Tax liability in the accounts for the year ended 31.03.2013.
- (v) A technical consultant was paid consultancy fee of ₹20,000 in cash by the assessee and deduction was claimed towards the expenditure.
- (vi) Stock in trade was lost in fire amounting to ₹20,000 and debited to Profit and Loss A/c.
- (vii) A lump sum consideration of ₹1,50,000 was paid to acquire know-how for the financial year 2012-13.
- (viii) Fees of ₹42,000 were paid by the company to a lawyer to defend the company in a court case. Lawyer is the brother of the director of the company. The fees have been paid by a bearer cheque and it is found excessive to the extent of ₹20,000.
- (ix) The assessee claims the set-off unabsorbed depreciation of ₹75,000 of a discontinued business against the profits of another business.
- (x) 1,000 wrist watches costing ₹1,000 each were presented to customers.

Solution:

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- (i) Section 40A(7) provides that any provision for gratuity in the books of accounts shall not be allowed as a deduction unless provision is made for any contribution towards an approved gratuity fund or provision is for gratuity, which has become due and payable during the previous year.
In the given case, gratuity has been provided in the books as per actuarial valuation but there is no liability due during the year. Hence, the amount of provision for gratuity i.e. ₹1,50,000 shall be disallowed.
- (ii) Section 37 provides that expenditure of revenue nature incurred wholly and exclusively in connection with business or profession, shall be allowed as deduction.
In the given case, the fees paid to the senior advocate to represent the Company in Income Tax proceeding is incurred wholly and exclusively in connection with business and hence, the same is fully allowed as deduction.
- (iii) Any expense incurred in connection with acquisition or construction of a capital asset should be capitalized.
In the given case, travelling expenses of ₹45,000 for negotiating purchase of plant and machinery which is a capital asset should be capitalized and not deductible.
- (iv) Section 43B provides that any sum payable by way of tax, duty, cess or fee under any law in force shall be allowed as deduction only if the same is paid on or before the due date of filing return of income u/s 139(1).
In the given case, a sum of ₹25,000 is provided as Sales Tax Liability in the books for the financial year 2012-13. If the amount so provided is paid before due date of filing the return, the same may be allowed as a deduction in the year of provision i.e. previous year 2012-13 or it may be claimed as a deduction in the year of payment.
- (v) Section 40A(3) provides that where an assessee incurs any expenditure in respect of which payment or aggregate of payments in excess of ₹20,000 is made otherwise than by Account Payee Cheque or Account Payee Demand Draft, whole of such expenditure shall be disallowed.
In the given case, the assessee has paid the technical consultant ₹20,000 only as consultancy fees and the same shall be allowed as a deduction.
- (vi) Loss of stock in trade by fire or other natural calamities or due to negligence of the employees is an allowable deduction.
Therefore, in the given case, the loss of stock in trade amounting to ₹20,000 in fire can be claimed as deduction by the assessee.
- (vii) Technical know-how, being an intangible asset, is eligible for depreciation @25% on Written Down Value Method.
In the given case, ₹1,50,000 has been paid in lump sum for acquisition of technical know-how. Hence, depreciation @ 25% amounting to ₹37,500 can be charged against revenue for the year.
- (viii) Section 40A(2) provides that if any payment, in respect of goods, services or facilities supplied or provided by a relative or a person having substantial interest, is considered to be excessive or unreasonable as compared with the market value of such goods, services or facilities, then the excessive or unreasonable sum shall not be allowed as a deduction.
Section 40A(3) provides that where an assessee incurs any expenditure in respect of which payment or aggregate of payments in excess of ₹20,000 is made otherwise than by Account Payee Cheque or Account Payee Demand Draft, whole of such expenditure shall be disallowed.
Payment made by the company to the brother of the director of the company, is covered under Sec. 40A(2).
Therefore, excessive fees of ₹20,000 have to be disallowed.

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Provisions of Sec. 40A(3) apply to the balance payment since it has been made by bearer cheque. Accordingly, the balance of ₹22,000 shall have to be disallowed in computing taxable business profits.

- (ix) Section 32(2) unabsorbed depreciation of a discontinued business can be set-off against the profits of any other business and thereafter against the income of any other head.
Hence, in the given case, the set-off unabsorbed depreciation of ₹75,000 of a discontinued business is allowable.
- (x) Presentation of wrist watches to customers is allowed as expenditure on advertisement under Sec. 37(1). The whole amount of ₹10,00,000 is allowable as deduction as there is no ceiling limit for gift articles.

12.

(a) AB Ltd. owns the following assets:

	Goodwill	Shares (non- listed)	House Property
Cost of acquisition	Self - generated	₹1,37,000	₹99,000
Date of acquisition	—	March 20, 2010	March 20, 2010

Goodwill has been recognised since the commencement of business on October 1, 1981.

These capital assets (no depreciation is claimed) are transferred by AB Ltd. to its wholly-owned Indian subsidiary company SL Ltd. on April 1, 2011. On June 17, 2012, these assets are transferred by SL Ltd. for consideration of ₹11,81,000 (i.e., goodwill: ₹7,00,000, shares : ₹2,16,000, house property : ₹2,65,000). Compute the capital gain chargeable to tax in the case of SL Ltd. for the assessment year 2013-14.

Solution:

	Goodwill ₹	Shares (non- listed) ₹	House Property ₹
Sale consideration	7,00,000	2,16,000	2,65,000
Less: Cost of acquisition to the previous owner	-	-	99,000
Less: Indexed cost of acquisition (i.e., ₹1,37,000 x 852 ÷ 632)	Nil	1,84,690	-
Short-term Capital Gain	-	-	1,66,000
Long-term Capital Gain	7,00,000	31,310	-

(b) Adi receives the following gifts during the previous year 2012-13—

- (i) On the occasion of marriage of Adi, he gets ₹3,00,000 as gift on April 12, 2012 (out of which ₹2,00,000 is received from his and his wife's friends and remaining amount is received from close relatives of Adi and his wife).
- (ii) On June 26, 2012, he gets a gift of ₹19,000 from Subir, who is cousin of his father.
- (iii) On August 18, 2012, he gets a gift of ₹25,000 from Deepak, who is elder brother of his grandfather.
- (iv) On September 18, 2012, he gets a gift of ₹7,50,000 from his grandmother.
- (v) A computer received from his employer (it was purchased for ₹75,000 by the employer on August 1, 2012 and given as gift to Adi on October 1, 2012).
- (vi) On October 22, 2012, Adi purchases a house property from his friend Dinesh for ₹7,85,000 (stamp duty value of the property is ₹10,00,000).
- (vii) On October 30, 2012, Adi gets a gift of a plot of land from his grandfather (stamp duty value is ₹12,00,000).
- (viii) On December 31, 2012, Adi gets by gift a commercial flat from the elder brother of his father-in-law (stamp duty value is ₹20,00,000).

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- (ix) On January 10, 2013, he gets a gift of ₹2,50,000 (cash gift of ₹ 30,000 and gift of a work of art whose market value is ₹2,20,000) from a notified public charitable institution.
- (x) Adi receives on January 11, 2013 a house property under will of a person known to him. The stamp duty value is ₹15,00,000.
- (xi) On January 19, 2013, he gets a wrist watch by gift (fair market value: ₹ 20,000) from his friend Badal.
- (xii) On January 21, 2013, he purchases a work of art for ₹15,00,000 from an exhibition in London (the fair market value of the work of art on the date of purchase is ₹18,00,000).
- (xiii) On February 2, 2013, he purchases a commercial property for ₹8,00,000 (stamp duty value is ₹ 9,00,000).
- (xiv) On February 6, 2013, he gets a birthday gift of a gold coin (fair market value: ₹10,000) from his friend.
- (xv) On February 10, 2013, Adi gets by way of gift a plot of land in Punjab from a partnership firm. The partnership firm has only two partners - Adi's father and wife. The stamp duty value of the plot of land is ₹ 29,00,000.
- (xvi) On February 16, 2013, Adi purchases 100 shares in HUL from his friend Rabi at ₹100 per share (outside stock exchange). The lowest market quotation in the Bombay Stock Exchange and the National Stock Exchange on the date of purchase is ₹ 500 and 510, respectively.
- (xvii) On March 2, 2013, Adi gets a gift of gold ring from a cousin of his mother-in-law. The fair market value is ₹15,000.
- (xviii) On March 21, 2013, Adi gets a painting by way of gift from X Ltd. in which his wife holds 75 per cent shares. The fair market value of painting is ₹20,000.
- (xix) On March 28, 2013, Adi gets a small plot of land by way of gift from a cousin of his wife (stamp duty value is ₹40,000).
- (xx) On March 31, 2013, Adi receives a shop (situated in Kashmir) by way of gift from a friend (stamp duty value is ₹45,000).

Compute the amount chargeable to tax in the hands of Adi under the head "Income from other sources" for the assessment year 2013-14.

Solution:

Particulars	Cash Gift (₹)	Gift of immovable property (₹)	Gift of movable property (₹)	Purchase of property for inadequate consideration (₹)
(i) Gift on occasion of marriage of Adi (not taxable)	Nil	-	-	-
(ii) Cash gift from Subir (not "relative")	19,000	-	-	-
(iii) Cash gift from Deepak (elder brother of grandfather is not "relative")	25,000	-	-	-
(iv) Cash gift from grandmother (gift from a "relative" is not taxable)	Nil	-	-	-
(v) Gift from employer (it is taxable under the head "Salaries")	-	-	-	-
(vi) Purchase of immovable property for inadequate consideration (not taxable)	-	-	-	Nil
(vii) Gift of immovable property from grandfather (gift from "relative" is not taxable)	-	Nil	-	-

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(viii) Gift of commercial property (elder brother of father-in-law is not "relative")	-	20,00,000	-	-
(ix) Gift from notified public charitable institute (not taxable)	Nil	-	Nil	-
(x) Gift under a will (not taxable even if received from a non-relative)	-	Nil	-	-
(xi) Gift of a wrist watch [wrist watch is not "property" for the purpose of section 56(2)(vii) and not taxable]	-	-	-	-
(xii) Purchase of a work of art for inadequate consideration	-	-	-	3,00,000
(xiii) Purchase of immovable property for inadequate consideration (not taxable)	-	-	-	Nil
(xiv) Gift of gold coin	-	-	10,000	-
(xv) Gift from a partnership firm (partnership firm is not "relative" even if relatives of Adi are partners)	-	29,00,000	-	-
(xvi) Purchase of shares for inadequate consideration [(₹500 – ₹100) x 100]	-	-	-	40,000
(xvii) Gift of gold ring (cousin of mother-in-law is not "relative" of Adi)	-	-	15,000	-
(xviii) Gift from a company (company is not a "relative" even if Adi's wife is a major shareholder)	-	-	20,000	-
(xix) Gift of plot of land (not taxable as stamp duty value does not exceed ₹50,000)	-	Nil	-	-
(xx) Gift of shop (not taxable as stamp duty value does not exceed ₹50,000)	-	Nil	-	-
Total	44,000	49,00,000	45,000	3,40,000

Amount taxable under section 56(2)(vii) under the head "Income from Other Sources" will be calculated as follows –

Particulars	₹
Cash gift (not taxable as the aggregate amount of cash gift does not exceed ₹50,000)	Nil
Gift of immovable properties	49,00,000
Gift of movable properties (not taxable as the aggregate amount does not exceed ₹ 50,000)	Nil
Purchase of movable properties for inadequate consideration	3,40,000
Amount Taxable under the head "Income from Other Source"	52,40,000

13.

(a) From the following information, find out the net income and tax liability of Mr. Roy (29 years), a resident individual, for the assessment year 2013-14:

Particulars	₹
Salary	3,72,000
Business Income (Non-speculative business)	(-)32,000
Long- term Capital Gain	60,000

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Short- term Capital Gain	15,000
Winning from horse race (gross)	45,000
Total	4,60,000
Mediclaime insurance on his own health	7,720
Contribution towards pension fund of LIC	11,580
Expenditure on medical treatment of a dependent relative (being a person with disability)	15,000
Deposit for maintenance of a dependent relative (being a person with disability)	30,000
Donation to the Government of India for family planning	76,000
Donation to the Central welfare Fund of India army	5,000
Life insurance premium on the life of Mrs. Roy	11,000

Solution:

In this case, taxable income does not exceed ₹5,00,000. The maximum marginal rate of tax is 20% which is not more than the tax incidence on Long-term Capital Gain. Therefore, it is better to set off business loss of ₹32,000 against Long-term Capital Gain of ₹60,000. Consequently, Long-term Capital Gain is reduced to ₹28,000.

Tax liability shall be determined as under —

Particulars	₹	₹
Gross Total Income (which includes long-term capital gain of ₹28,000 and winnings from races of ₹45,000)		4,60,000
Less : Deductions under sections 80C to 80U		
Under section 80C	11,000	
Under section 80CCC	11,580	
Under section 80D	7,720	
Under section 80DD [see Note 1]	50,000	
Under section 80G [see Note 2]	40,170	1,20,470
Total Income		3,39,530
Tax on Total Income		
Tax on winning from races [30% of ₹45,000]		13,500
Tax on long-term capital gain [20% of ₹28,000]		5,600
Tax on income other than long-term capital gain [tax on (₹3,39,530 - ₹45,000 - ₹28,000)]		6,653
Tax		25,753
Add: Surcharge (not applicable)		Nil
Add: Education cess @ 2%		515
Add: Secondary and higher education cess @ 1%		258
Tax payable (round off)		26,530

Notes:

- The amount of deduction under section 80DD is ₹50,000 irrespective of the expenditure incurred or deposited.
- Deduction under section 80G - First one has to compute adjusted gross total income which is as follows —

Particulars	₹
Gross Total Income	4,60,000
Less:	
Long-term Capital Gain	(-) 28,000

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Amount of deduction under section 80C to 80U (but not section 80G) [i.e., ₹11,000 + ₹11,580 + ₹7,720 + ₹50,000]	(-) 80,300
Adjusted Gross Total Income	3,51,700
Amount of deduction – It is determined as follows –	
Donation for family planning [i.e., maximum : ₹ 35,170, being 10% of adjusted gross total income; rate of deduction: 100%]	35,170
Donation to Central Welfare Fund of India army [no maximum ceiling, rate of deduction : 100%]	5,000
Total Deduction u/s 80G	40,170

(b) W Ltd., a company providing telecommunication services, obtains a telecom licence on April 1, 2005 for a period of 10 years which ends on March 31, 2015. The telecom licence is not renewable. The following two options are given to W Ltd. to pay the licence fees —

(1) to pay ₹10 Lakhs on April 1, 2005; or

(2) to pay ₹12 Lakhs on April 1, 2009.

Assume that each year's total receipts and expenses (excluding payment of licence fees) will be ₹60 Lakhs and ₹40 Lakhs, respectively, and the company wants to avail the benefit of tax holiday under section 80-IA from the first year, find out the better option.

Solution:

Option 1:

	Assessment Years	
	2006-07 to 2010-11 [₹ Lakhs]	2011-12 to 2015-16 [₹ Lakhs]
Gross Receipts	60	60
Less: Amount of deduction under section 35ABB on account of payment of licence fees [i.e., ₹10 Lakhs / 10]	1	1
Less: Other expenses	40	40
Business Income	19	19
Any other income	-	-
Gross Total Income	19	19
Less: Deduction under section 80-IA [100% for first 5 years and 30% for next 5 years]	19	5.7
Net Income	Nil	13.3

Option 2:

	Assessment years		
	2006-07 to 2009-10 [₹ Lakhs]	2010-11 [₹ Lakhs]	2011-12 to 2015-16 [₹ Lakhs]
Gross Receipts	60	60	60
Less: Amount of deduction under section 35ABB[i.e., ₹12 Lakhs / 5]	-	2.4	2.4
Less: Other expenses	40	40	40
Business Income	20	17.6	17.6
Any other income	-	-	-
Gross Total Income	20	17.6	17.6
Less: Deduction under section 80-IA [100% for first 5 years and 30% for next 5 years]	20	17.6	5.28

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Net Income	Nil	Nil	12.32
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It is, therefore, better to opt for the option 2.

(c) Ravi, a member in two AOPs namely RLT & Co. and Ravi & Rina, provides the following details of his income for the year ended on 31.03.2013 -

- (i) RLT & Co. assessed at normal rates of tax had credited in his account amount of ₹1,60,000 as interest on capital, ₹2,10,000 as salary and ₹50,000 as share of profit.
- (ii) A house property located at Chennai was purchased on 01.07.2008 with the borrowed capital in Ravi & Rina jointly shared equally and occupied by both of them for self residential purposes. Total interest paid for the year 2012-13 on the borrowed capital was ₹5,00,000.

Compute the Income and the Tax Liability thereon for the A.Y. 2013-14 and support your answer with brief reasons.

Solution:

Assessee: Ravi

Previous Year: 2012-13

Assessment Year: 2013-14

Computation of Total Income and Tax Liability

Particulars	₹	₹
Income under the head House property		
Net Annual Value (Self Occupied Property)	Nil	
Less: Deduction u/s 24		
Interest [5,00,000 x 50%] - Restricted to ₹1,50,000	(1,50,000)	(1,50,000)
Profits and Gains from Business or Profession		
Interest on capital	1,60,000	
Salary	2,10,000	
Share income from AOP & Co.	50,000	4,20,000
Gross Total Income		2,70,000
Less: Deduction under Chapter VI-A		Nil
Total Income		2,70,000
Tax on Total Income		7,000
Add: Education Cess at 2%		140
Add: Secondary and Higher Education Cess at 1%		70
Tax Payable		7,210
Average Rate of Tax (Total Tax Payable / Total Income)		2.67%
Less: Rebate u/s 110 [AOP Income x Average rate of tax] [₹4,20,000 x 2.67% = ₹11,214. Rebate restricted to tax payable]		(7,210)
Net Tax Payable		NIL

Working Note:

- I. As per section 26, where the house property is owned by two or more persons whose share is definite and ascertainable, the income from such property shall be taxed in the individual assessment of the members.
- II. If the property is self-occupied, then the part of self occupancy is applicable to each co-owner individually and they are entitled for deduction u/s 24 independently.
- III. If AOP is chargeable to tax at normal rate applicable for individuals, then the member is eligible for rebate u/s 110.

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14.

(a) Grass Ltd. is an Indian company. It owns an industrial undertaking which was started on July 1, 2009.

On March 31, 2012, it has 411 employees (Category A: 35; Category B: 40; Category C: 336).

During the previous year 2012-13, it gives employment to the following persons (salary being ₹2,500 per month per person for the employees of Category B and C and ₹15,000 for the employees of Category A)—

	Situation I (No. of employees)	Situation II (No. of employees)
Managerial personnel (Category A)	3	5
Casual workmen (Category B)	15	20
Other workmen (Category C) (employed with effect from June 1, 2012)	37	39
Other workmen (Category C) (employed with effect from December 1, 2012)	25	35
Number of new employees employed during the financial year 2012-13	80	99

Find out the amount of deduction under section 80JJAA for the assessment year 2013-14.

Solution:

	Situation I	Situation II
Number of "workmen" as on March 31, 2012 (Category B + C; Category A employees are not "workmen")	376	376
10% of above	37.6	37.6
Minimum number of "regular workmen" which should be newly employed during the previous year 2012-13 to get the benefit of deduction under section 80JJAA	38	38
Number of "regular workmen" actually employed during the financial year 2012-13 (Category C)	37	39
Whether deduction is available under section 80JJAA	No	Yes

In Situation II the amount of deduction will be as follows:

	₹
Salary payable to newly employed "regular workmen" during the financial year 2012-13 (39 × ₹2,500 × 10 months)	9,75,000
Amount deductible under section 80JJAA (30% of ₹9,75,000)	2,92,500

Note: Salary payable to all employees (Categories A, B and C) is deductible under section 37. Deduction under section 80JJAA, as computed above, is in addition to the deduction available under section 37.

(b) WC Ltd. is engaged in the business of manufacture of garments.

Particulars	₹
Sale proceeds of goods (domestic sale)	22,26,900
Sale proceeds of goods (export sale)	5,86,100
Amount withdrawn from general reserve (reserve was created in 2006-07 by debiting P&L A/c)	3,00,000
Amount withdrawn from revaluation reserve	1,00,000

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Total	32,13,000
Less : Expenses	
Depreciation (normal)	6,17,000
Depreciation (extra depreciation because of revaluation)	2,75,000
Salary and wages	2,20,000
Wealth-tax	15,000
Income-tax	3,60,000
Outstanding customs duty (not paid yet)	17,000
Proposed dividend	80,000
Consultation fees paid to a tax expert	24,000
Other expenses	1,45,000
Net Profit	14,60,000

For tax purposes the company wants to claim the following:

- Deduction under section 80-IB (30% of ₹14,60,000)
- Depreciation under section 32 (₹5,40,000)

The company wants to set off the following losses/allowances :

	For tax purposes ₹	For accounting purposes ₹
Brought forward loss of 2007-08	14,70,000	5,00,000
Unabsorbed depreciation	-	90,000

Compute the net income and tax liability of WC Ltd. for the assessment year 2013-14 assuming that WC Ltd. has a (deemed) Long-term Capital Gain of ₹70,000 under proviso (i) to section 54D(2) which is not credited in Profit and Loss Account.

Solution:

Particulars	₹
Net profit as per P&L A/c	14,60,000
Add:	
excess depreciation [i.e., ₹6,17,000 + ₹2,75,000 – ₹5,40,000]	3,52,000
Wealth-tax	15,000
Income-tax	3,60,000
Customs duty which is not paid	17,000
Proposed dividend	80,000
Total	22,84,000
Less : Amount withdrawn from reserve (i.e., ₹3,00,000 + ₹1,00,000)	4,00,000
Business Income	18,84,000
Less : Unabsorbed loss	14,70,000
Business income	4,14,000
Long-term Capital Gain	70,000
Gross Total Income	4,84,000
Less : Deductions under section 80-IB [30% of ₹4,14,000]	1,24,200
Net Income	3,59,800
Tax liability (under normal provisions) [20% of ₹70,000 + 30% of ₹2,89,800, plus 3% of tax as Education Cess and SHEC]	1,03,968
Book Profit	

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Net Profit	14,60,000
Add:	
Depreciation [i.e., ₹6,17,000 + ₹2,75,000]	8,92,000
Wealth-tax	Nil
Income-tax	3,60,000
Proposed dividend	80,000
Total	27,92,000
Less :	
Amount withdrawn from general reserve	3,00,000
Unabsorbed depreciation	90,000
Depreciation (normal)	6,17,000
Amount withdrawn from revaluation reserve to the extent it does not exceed extra depreciation because of revaluation	1,00,000
Book Profit	16,85,000
Tax liability (19.055% of book profit)	3,21,077

WC Ltd. will pay ₹3,21,077 as tax for the assessment year 2013-14 as per section 115JB. Tax credit is however, available in respect excess tax (i.e., ₹2,17,109) under section 115JB.

15.

(a) Z Ltd. furnishes the following particulars. Compute the total taxable income of the company for the assessment year 2013-14 (accounting year ended on March 31, 2013).

Particulars	₹ (in lakh)
1. Net Income (from which penal interest of ₹30,000 paid for delayed payment of sales tax and interest of ₹1.75 Lakhs paid on fixed deposits from public have been deducted) subject to the following adjustments :	31,66,000
➤ depreciation which included ₹0.60 Lakh for guest house building	1,75,000
➤ unabsorbed depreciation of the assessment year 2006-07	7,35,000
➤ unabsorbed business loss brought forward from the assessment year 2006-07	24,50,000
2. Short-term Capital Gain on sale of shares (trade investment)	98,000
3. Long-term Capital Gain on sale of equity shares on May 25, 2012 (computed under section 48)	2,55,000
4. Brought forward Short-term Capital Loss from the assessment year 2007-08	46,000
5. Brought forward Long-term Capital Loss of the assessment year 2008-09 on sale of shares	52,000
6. Gross interest from Government securities	1,39,000
7. Bank commission, etc., for realising interest	4,000

Solution:

	₹	₹
Income from business		
Business income	31,66,000	
Less: Depreciation	1,75,000	
	29,91,000	
Less: Brought forward business loss	24,50,000	

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	5,41,000	
Less: Unabsorbed depreciation	5,41,000	
Income from Business		Nil
Capital Gains:		
Short-term Capital Gains	98,000	
Long-term Capital Gains	2,55,000	
	3,53,000	
Less: Brought forward Short-term Capital Loss	46,000	
	3,07,000	
Less: Brought forward Long-term Capital Loss	52,000	2,55,000
Income from Other Sources		
Interest on Government securities	1,39,000	
Less: Bank Commission	4,000	1,35,000
Gross Income before unabsorbed depreciation		3,90,000
Less: Unabsorbed depreciation		1,94,000
Gross Total Income		1,96,000
Less: deductions under Chapter VI – A		Nil
Net Income		1,96,000

Notes:

- (I) It is assumed that net income of ₹31.66 Lakhs has been arrived at after debiting interest of ₹30,000 paid for delayed payment of sales tax and interest of ₹1.75 Lakhs paid on fixed deposits from public.
- (II) Penal interest for delayed payment of sales tax is admissible as business expenditure, not being in the nature of penalty – Mahalakshmi Sugar Mills Co. vs. CIT [1980] 123 ITR 429 (SC).
- (III) If equity shares are transferred in the above case in a recognised stock exchange by paying STT, then the Long-term Capital Gain will be exempt from tax.

(b) Cash Book of Om Ltd. for financial year 2012-13 is given below:

Cash Book

Dr.		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)
To, Balance b/d	16,700	By, Salaries & Wages A/c	9,89,000
To, Sale of centrifuged latex	17,55,300	By, Electricity Charges A/c	36,000
To, Interest on Bank FD	48,000	By, Printing & Stationery A/c	3,890
		By, Other Expenses A/c	32,110
		By, Amount deposited to Special A/c [specified by Rubber Board and approved by Central Govt.]	2,50,000
		By, Amount deposited to an account not specified by Central Govt.	4,50,000
		By, Bank Charges A/c	1,700
		By, Balance c/d	57,300
	18,20,000		18,20,000

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Additional Information:

(i) Depreciation allowed u/s 32 of Income Tax Act is ₹38,500 but depreciation to be charged to the Profit & Loss A/c is ₹41,600.

(ii) Unabsorbed business loss brought forward is ₹35,000[A.Y. 2010-11].

You are required calculate the Taxable Business Profit for the Assessment Year 2013-14 after preparing Profit & Loss A/c.

Solution:

Profit & Loss A/c For the year ended 31st March, 2013

Particulars	Amount (₹)	Particulars	Amount (₹)
To, Salaries & Wages A/c	9,89,000	By, Sale of centrifuged latex	17,55,300
To, Electricity Charges A/c	36,000	By, Interest on Bank FD	48,000
To, Printing & Stationery A/c	3,890		
To, Other Expenses A/c	32,110		
To, Bank Charges A/c	1,700		
To, Depreciation A/c	41,600		
To, Net Profit - transferred	6,99,000		
	18,03,300		18,03,300

Statement showing calculation of Business Income for the Assessment Year 2013-14

Particulars	Amount (₹)	Amount (₹)
Net Profit as per Profit & Loss A/c		6,99,000
Add: Depreciation debited to Profit & Loss A/c		41,600
		7,40,600
Less: depreciation allowable under Section 32		38,500
Income chargeable under other head		48,000
Business Profit		6,54,100
Less: Deduction u/s 33AB:		
Least of the following:		
(a) 40% of the Profit from the business	2,61,640	
(b) Amount deposited within the specified time in the specified account	2,50,000	2,50,000
Profit of the Business		4,04,100
Less: Agricultural Income [as per Rule 7A]		2,62,665
Business Income		1,41,435
Less: Unabsorbed business loss		35,000
Taxable Business Income		1,06,435

(c) Mac, a foreign technician, is sent by F Ltd., a foreign company, to India in terms of a collaboration agreement dated 1st February, 2010 with J Ltd., an Indian company, to assist the Indian company in setting up a plant. The fees charged by F Ltd. are ₹6,000 per day for every day stay in India of Mac for such work. Mac draws total emoluments of ₹2,500 per day out of which a sum of ₹1,500 per day is paid by J Ltd. Mac stays in India for 80 days. What are the tax effects in India of the transactions?

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Solution:

Assessment of Mac: It is assumed that Mac has come to India as an employee of the foreign company and not of the Indian Company. As his stay in India is for 80 days i.e. less than 90 days, his salary is not deductible in computing business income of his employer. Salary income is taxable in his hands as it accrued, arose and received in India.

Assessment of F Ltd.: The entire receipt of ₹6,000 per day for 80 days i.e. ₹4,80,000 becomes chargeable to tax in its hands as fees for technical services u/s 9(1)(vi) @10% plus surcharge plus EC & SHEC as per section 115A.

Assessment of J Ltd.: Since Mac comes to India to assist J Ltd. in setting up the plant, the expenses incurred on this account by J Ltd. are in the nature of expenses incurred for erection of machinery and putting the items of plant in working condition and can, therefore, be capitalised and treated as part of the "actual cost" of plant and machinery.

16.

(a) Heritage Co-operative Society, which is engaged in processing agricultural produce of its members, without the aid of power and its marketing, furnishes the following particulars, determine its net income for the assessment year 2013-14:

Income from processing of agricultural produce: ₹19,000; income from marketing agricultural produce: ₹2,000; dividends from another co-operative society: ₹50,000; income from letting of godowns: ₹20,000; and income from agency business: ₹95,000.

Solution:

	₹	₹
Income from letting of godowns		20,000
Business income:		
• from processing	19,000	
• from marketing	2,000	
• from agency	95,000	1,16,000
Dividend income		50,000
Gross Total Income		1,86,000
Less: deductions in respect of income from		
a. processing of agricultural produce [Sec. 80P(2)(a)]	19,000	
b. marketing of agricultural produce [Sec. 80P(2)(a)(iii)]	2,000	
c. agency business [Sec. 80P(2)(c)] [maximum of ₹50,000]	50,000	
d. dividend [Sec. 80P(2)(d)]	50,000	
e. letting of godowns [Sec. 80P(2)(e)]	20,000	1,41,000
Net Income		45,000

(b) During the Previous Year 2012-13, Mrs. Ghose (aged 49 years) pays the following installments of advance tax :

	₹
On September 15, 2012	8,000
On December 15, 2012	13,000
On March 15, 2013	17,000
On March 16, 2013	22,000

Mrs. Ghose files return of ₹8,00,000. Assessment is also completed on the basis of income returned by Mrs. Ghose after making addition of ₹50,000 (date of assessment order: November 25, 2013). Mrs. Ghose is entitled to tax credit of ₹15,300 on account of tax deducted at source. Compute interest under sections 234B and 234C.

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Solution:

Interest liability under section 234B:

	₹
Income (8,00,000+50,000)	8,50,000
Tax on ₹ 8,50,000 (including Education Cess and SHEC)	1,03,000
Less: Tax deducted at source	15,300
Assessed Tax	87,700
90% of Assessed Tax	78,930
Advance tax paid during 2012-13 [i.e., ₹ (8,000 + 13,000 + 17,000 + 22,000)]	60,000

Since advance tax during the previous year 2012-13 is less than 90% of assessed tax, Mrs. Ghose is liable to pay interest under section 234B, i.e., on the shortfall of ₹27,700 (being ₹87,700 – ₹60,000) for 8 months (₹27,700 × 1/100 × 8) which comes to ₹2,216.

Interest liability under section 234C:

Tax on ₹ 8,00,000 = 90,000 + 3% on Education and Higher Education Cess = 92,700

Due date	Advance Tax Payment ₹	Advance Tax paid ₹	Cumulative Advance Tax paid before due date ₹	Shortfall in Payment ₹	Surplus ₹	Months	Interest @ 1% p.m. ₹
15.9.2012	30% of ₹92,700 = 27,810	8,000	8,000	19,810	—	3	594
15.12.2012	60% of ₹92,700 = 55,620	13,000	21,000	34,620	—	3	1,039
15.3.2013	100% of ₹92,700 = 92,700	39,000	60,000	32,700	—	1	327
							1,960

(c) Samir fails to quote PAN as per the provisions of Section 139A. What is the consequence of such failure?

Solution:

As per section 272B(2), if a person fails to comply with the provisions of section 139A, the Assessing Officer may direct that such person shall have to pay, by way of penalty, a sum of ₹10,000.

Hence, in the above case, Samir has to pay penalty as directed by the Assessing Officer.

(d) The return of S & sons was taken up for scrutiny assessment by issuing notice u/s 143(2). S & sons were in the business of plying of goods carriages owning 9 lorries and had returned an income of ₹5,40,000. The Assessing Officer noticed that a cash payment of ₹55,000 made to a single party on the same day for the purpose of purchase of tyres and spares had been claimed as expenses. He wants to add this to the returned income. Is the AO correct in his view?

Solution:

Presumptive income u/s 44AE for heavy goods vehicle is ₹5,000 per month or part thereof, from date

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of ownership.

In the instant case, S & sons have operated 9 Heavy Goods vehicles and have returned an income of ₹5,40,000 i.e. ₹5,000 p.m. per vehicle x 12 Months x 9 Vehicles, by opting for provisions u/s 44AE. Hence, in respect of income declared by S & sons, no deduction can be made u/s 30 to 38 or any addition u/s 40. Therefore, the action of the Assessing Officer is not correct.

17.

(a) For the assessment year 2013-14, net agricultural income of an assessee is ₹95,000 and non- agricultural income is ₹14,85,000. The taxpayer contributes ₹80,000 towards Public Provident Fund. Finds out the tax if the taxpayer is (a) A, an individual (27 years), (b) B, a HUF, (c) C, a firm assessed as such, (d) D Ltd. an Indian company.

Solution:

Computation of tax in the case of A (Individual) and B (HUF) as follows:

Particulars	Amount (₹)
Gross Total Income	14,85,000
Less: deduction under section 80C	80,000
Total Income	14,05,000
Income- tax on ₹15,00,000 (i.e., agricultural income: ₹95,000 + non-agricultural income: ₹14,05,000) [a]	2,80,000
Income-tax on agricultural income: ₹95,000 + exempted slab of income ₹2,00,000 [b]	9,500
Income-tax computed at [a] minus income-tax computed at [b]	2,70,500
Add: surcharge	Nil
Tax and surcharge	2,70,500
Add: Education cess @ 2%	5,410
Add: Secondary and higher education cess @ 1%	2,705
Tax payable	2,78,615

In the case of C (a firm) and D Ltd. tax liability will be as follows:

Particulars	Amount (₹)
Tax on non-agricultural income of ₹14,85,000 @30% [agricultural income is not considered in the case of firm and companies]	4,45,500
Add: Surcharge	Nil
Tax and surcharge	4,45,500
Add: Education cess @ 2%	8,910
Add: Secondary and higher education cess @ 1%	4,455
Tax liability	4,58,865

(b) Briefly describe the conditions that are required to be satisfied in order to claim exemption under section 11.

Solution:

The following essential conditions are to be fulfilled for claiming exemption u/s 11:

- The property from which income of the trust is derived should be held for charitable or religious purposes. In case of a charitable trust created on or after 1st April, 1962, the further conditions are:

(A) the trust should not be created for the benefit of any particular religious community

or caste;

(B) no part of the income should be enure, directly or indirectly, for the benefit of the settler or other specified persons; and

(C) the property should be held wholly for charitable purposes.

The conditions mentioned at (B) and (C) also apply to religious trusts created on or after 1st April, 1962.

- (ii) The exemption is confined to only such portion of the trust's income which is applied to charitable or religious purposes or is accumulated for applying to such purposes within the limits of accumulation permitted u/s 11(1) and (2).
- (iii) The exemption is restricted to such portion of the trust's income as is applied to charitable or religious purposes in India except in cases enumerated in Sec.11(1)(c).
- (iv) If the trust property comprises of a business undertaking, the income shown in the books of account should not be less than the income determined by the Assessing Officer according to provisions of the Income-tax Act. From A.Y. 1992-93, trusts or institution can carry out business activities if such business activities are incidental to the attainment of its objectives and separate books of accounts are maintained.
- (v) The trust should make an application in Form No. 10A to the Commissioner of Income Tax within one year of creation of trust or the institution and such trust or institution get registered u/s 12AA.
- (vi) Limit for audit of charitable institutions rationalized [Section 12A]
 - Trusts and institutions covered under sections 11 and 12 to get their accounts audited only when their total income, before giving effect to the provisions of sections 11 and 12, exceeds ₹1,00,000.
- (vii) The funds of the trust should be invested or deposited in any one or more of the modes or forms [Sec. 11(5)] such as —
 - investment in Government Savings Certificate;
 - deposits in any Post Office Savings Bank Account;
 - deposit in any account with any Scheduled or Cooperative Bank;
 - investment in any Central Government or State Government securities or in the units of the Unit Trust of India;
 - investment in debentures of any corporate body, guaranteed by the Central Government or a State Government ;
 - investments in immovable property or deposit in any public sector company ;
 - deposit or investments in any Bond issued by a public company having main object of carrying on business of providing long term finance for urban infrastructure in India.
 - any other form or mode of investment/deposit as may be prescribed in this behalf.

(c) 'Balancing Charge will arise when an electricity company sells its assets' – Do you agree with the statement? Answer with reason.

Solution:

In the case of an undertaking engaged in the generation or generation and distribution of power, option is available to claim depreciation on straight line method with reference to each individual asset. If such option is exercised, block of asset concept does not apply. In the case of such an assessee, where any building, machinery, plant or furniture is transferred for a consideration which is more than the depreciated value, the surplus to the extent of depreciation already allowed shall be assessed as business income. This is normally described as 'Balancing Charge' [Section 41(2)].

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Hence, it is not necessary that every time an electricity company sells its assets, 'Balancing Charge' will arise.

18.

(a) Avik, a trader, sells goods on credit to Aman (outstanding balance on 1st April, 2011 - ₹50,000 and total bills issued during the financial year 2011-12 - ₹70,000). Out of ₹1,20,000, he recovers only ₹20,000 from Aman during the financial year 2012-13. On 31st March, 2012, he writes off ₹40,000 as bad debt. However, on 30th December, 2012, Avik recovers from Aman as full and final settlement (i) ₹20,000 or (ii) ₹59,000 or (iii) ₹80,000. Find out the tax consequences for different assessment years.

Solution:

Assessment Year 2012-13 – During the previous year 2012-13, Avik writes off ₹40,000 as bad debt. It is, therefore, deductible for the assessment year 2012-13.

Assessment Year 2013-14 – Tax treatment, when recovery is made during the previous year 2012-13, will be as follows –

Amount of debt as on 1 st April, 2013 (i.e. ₹1,20,000 - ₹20,000 - ₹40,000 being the amount written off) [1] (₹)	Amount recovered as full and final settlement [2] (₹)	Income /(Deduction) [2-1] (₹)
(i) 60,000	20,000	(40,000)
(ii) 60,000	59,000	(1,000)
(iii) 60,000	80,000	20,000

In situation (i) ₹40,000 is deductible as bad debt, if he writes off ₹40,000 in his books of accounts as bad debt during the previous year 2012-13. Likewise, in situation (ii) ₹1,000 is deductible as bad debt, if Avik writes off ₹1,000 in his books of account for the year ended 31st March, 2013. In situation (iii), however, ₹20,000, being the excess recovery, is taxable as business income by virtue of section 41(4) for the previous year 2012-13 [irrespective of the fact whether the business is in existence during the previous year 2012-13 or not].

(b) Ganesh had placed a deposit of ₹15,00,000 in a bank on which he received interest of ₹95,000. He had also borrowed ₹10,00,000 from the same bank on the security of the deposit and was liable to pay ₹65,000 by way of interest to the bank. He therefore offered the difference between two amounts of ₹30,000 [i.e. ₹95,000 - ₹65,000] as Income from Other Sources. Is this correct?

Solution:

Section 57 provides that any expenditure (not being capital expenditure) expended to earn income chargeable under the head "Income from Other Sources" will be allowed as deduction against such income.

Interest on Bank FD was the income in the hands of the assessee. The interest on the loan taken from bank on that deposit is not an allowable expenditure as it is not expended to earn the interest on Bank FD.

Therefore, in the given case, the interest of ₹65,000 paid by Ganesh is not allowable as deduction and the entire interest of ₹95,000 is fully taxable.

(c) Mr. Singh gifts ₹5,00,000 to Mrs. Singh on 1st January 2013. Mrs. Singh invests the same in her existing crockery business where she has already invested ₹5,00,000. Mrs. Singh earns

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₹10,00,000 from the business during the previous year 2012-2013. How would you assess the profits?

Solution:

The previous year of the existing business is April to March. On the first day of the previous year (i.e. 1st April 2012), total investment has come from Mrs. Singh account. As the proportion of the gifted amount from spouse on 1st April 2012 to the total investment in business on the same day is NIL, the whole of the profits of ₹10,00,000 for the previous year 2012-13 will be included in the total income of Mrs. Singh.

19.

(a) Sanrakshan is an institution, having main object 'preservation of Wildlife; used the entire income derived from an activity in the nature of trade for its main object during the previous year ended on 31.03.2013. The institution seeks your opinion to know whether such utilization of its income be treated for "Charitable Purpose"? Would your answer be different, if the main object of the institution is "Advancement of object of general public utility"?

Solution:

W.r.e.f. assessment year 2009-10 preservation of Environment, which includes water sheds forests and wildlife, is treated as charitable purpose. The entire income derived from an activity in the nature of trade and applied for its main object will be considered as charitable purpose and the exemption u/s 11 shall apply.

If the object of the Charitable Trust is general public utility and it involves in carrying of any activity in the nature of trade, commerce or business, or rendering any service in relation to trade, commerce, or business for cess, fees or other consideration and the aggregate value of receipts from the said activities does not exceed ₹25,00,000, the benefit of exemption shall continue.

(b) In an order of assessment for the assessment year 2012-13, an assessee noticed a mistake for which application u/s 154 was moved and the order was rectified. Subsequently, the assessee moved further application for rectification u/s 154, which was rejected by the Assessing Officer on the ground that the order once rectified, cannot be rectified again. Is the contention of the Assessing Officer correct?

Solution:

Section 154 provides that any order passed by the Income Tax Authority can be rectified provided there is an error apparent from the record which may be a mistake of fact or mistake of law but not a disputable one. The order can be rectified within 4 years from the end of the financial years in which such order was passed.

Order once amended can be rectified again provided there is a mistake apparent on record, which is rectifiable. In case of re-assessment, the time limit of 4 years for rectification runs from the date of re-assessment order and not from the date of original assessment order [Hind wire Industries Ltd. 212 ITR 639 (SC)].

Therefore, in the given case, the second application of the assessee cannot be rejected by the Assessing Officer, provided the application is made within the time limit of 4 years as mentioned above. Therefore, the action of the Assessing Officer is not correct.

(c) "An advance ruling can become void" – Discuss.

Solution:

As per section 245T, an advance ruling can be void ab initio by the Authority for Advance Ruling if, on a representation made to it by the Commissioner or otherwise, it finds that the ruling has

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been obtained by fraud or misrepresentation of facts. Thereafter, all the provisions of the Act will apply as if no such advance ruling has been made. A copy of such order shall be sent to the applicant and the Commissioner.

(d) A Firm carrying on business filed a return of income disclosing an income of ₹85,000 in 28th November, 2012 in respect of assessment year 2012-13. It discovered an omission therein and therefore filed a revised return u/s 139(5) in 27th January, 2013 showing a revised income of ₹60,000. The Assessing officer, however, ignored the revised return and proceeded to process u/s 143(1)(a) on the original return. Comment.

Solution:

Section 139(5) provides that any return filed within the time limit u/s 139(1) or u/s 142(1) can be revised if there is any omission or error in the original return.

Where belated return is filed u/s 139(4), being not the return filed within time limit u/s 139(1), assessee cannot file a revised return u/s 139(5). [Kumar Jagadish Chandra Sinha 220 ITR 67(SC)]

In the given case, the original return is filed belatedly and hence, the revised return cannot be accepted.

20.

(a) The return of income filed by Mr. Hari for the assessment year 2011-12 has been accepted under the provisions of Sec. 143(1) of the income Tax Act. Can the Commission of Income Tax interfere under his revisional powers and modify the assessment – (a) In a case where intimation is served u/s 143(1) and (b) In a case where no intimation is served.

Solution:

Power of Commissioner to revise intimation u/s 143(1):

Intimation sent by the Assessing Officer, in law, will have to be understood as having the force of an order on self-assessment and it shall be deemed to be notice of demand issued u/s 156. Such intimation is also subject to revision u/s 263 of the Act by the Commissioner.

In the given case, intimation has been served on the assessee and no assessment order has been passed. In view of the above, Commissioner can interfere under his revisional powers to modify an intimation.

No intimation is served:

When no intimation is served, (i.e., where no sum is payable or refundable to the assessee), then the return of income as acknowledged shall be deemed to be intimation u/s 143(1) and hence the Commissioner can interfere with his revisional powers and modify the assessment under sections 263 and 264.

(b) 'The powers of the Commissioner of Income Tax (Appeals) to enhance the assessment are plenary and quite wide' – Discuss.

Solution:

The Commissioner of Income Tax (Appeals) has powers to call for information u/s 133, to direct discovery and production of evidence u/s 131, rectification of mistake u/s 154, inspect register of Companies u/s 134 etc.

Section 251 provides that the Commissioner of Income Tax (Appeals) can enhance the assessment or the penalty during the course of appeal before him. However, such enhancement can be made only after a reasonable opportunity of being heard is provided to the assessee. Further, such enhancements can be appealed against by the assessee before the Income tax Appellate Tribunal.

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Based on the above points, it is correct to state that powers of the Commissioner of Income Tax (Appeals) are wide and extensive.

(c) **“An appeal shall lie to High Court against the order of the Tribunal” – Discuss the statement's correctness or otherwise.**

Solution:

The Tribunal is the final fact finding Appellate Authority and consequentially any order by the Tribunal on facts shall be final and cannot be taken up by the High Court.

Where order issued by the Tribunal involves a substantial question of Law, then either the Assessee or the Department can file an appeal to the High Court within 120 days from the date of receipt of Tribunal's order.

In view of the above, the order of Tribunal shall lie to the High Court, if it involves substantial question of law.

(d) **Samadhan Ltd. entered into an agreement for the warehousing of its products with Life Warehousing and deducted tax at source as per provisions of Section 194C out of warehousing charges paid during the year ended on 31.03.2013. The Assessing Officer while completing the assessment for A.Y. 2013-2014 of Samadhan Ltd. asked the Company by treating the warehousing charges as rent as defined in section 194-I to make payment of difference amount of TDS with interest. It submitted by the Company that the receipt had already paid tax on the entire amount of warehousing charges and therefore, now the difference amount of TDS can be not recovered. However, it will make the payment of due interest on the difference amount of TDS.**

Solution:

TDS has to be deducted u/s 194-I from payment made towards warehousing charges [Circular No. 718/22.8.1995].

Further, No demand u/s 201(1) should be enforced after the tax deductor has satisfied the Officer-In-Charge of TDS that the taxes due have been paid by the deductee–assessee. However, this will not alter the liability to charge interest u/s 201(1A) till the date of payment of taxes by the deductee or the liability for penalty u/s 271C. [Hindustan Coco coal Beverage (P) Ltd vs. CIT 293 ITR 226 (SC)].

In the instant case, Samadhan Ltd. has deducted tax u/s 194C at 1% instead of 10% u/s 194-I. However it is mentioned that warehousing has already paid the tax on its income from Samadhan Ltd.

If Samadhan Ltd. proves to the satisfaction of the Assessing Officer that the taxes have paid on the relevant income by the deductee, then the Assessing Officer cannot recover the TDS amount from it. However, Samadhan Ltd. is liable for interest on the differential amount at 1% per month or part of a month.

Section B – Wealth Tax

21.

(a) **Rishi has the following assets on 31st March, 2013:**

Asset	Market Value (₹)	Loan Outstanding (₹)
Gold	87,00,000	10,00,000
Residential House at Pune	45,00,000	2,00,000
Residential House at Andheri	90,00,000	27,00,000

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Residential House at Mahape (Let out though out the year)	65,00,000	11,00,000
Commercial House at Thane used for his own business	1,15,00,000	50,00,000
Shares	25,00,000	5,00,000
Boat	1,50,000	2,50,000
Motor Car	9,00,000	3,00,000
Bank deposit	58,00,000	Nil
Commercial complex at Andheri having 25 offices	2,50,00,000	1,55,00,000

Besides above mentioned loans, Rishi took a loan of ₹1,00,000 from his bank for his brother's marriage. Moreover, out of loan of ₹2,50,000 taken for boat, he utilized ₹50,000 for financing expenses on his foreign visit.

Determine his net wealth.

Solution:

Net wealth of Rishi shall be determined as under:

Asset	Market Value (₹)	Loan outstanding (₹)
Gold	87,00,000	10,00,000
Residential House at Pune	45,00,000	2,00,000
Residential House at Andheri [exempt u/s 5(vi)]	—	—
Residential House at Mahape (Let out though out the year) [not an asset]	—	—
Commercial House at Thane used for his own business [not an asset]	—	—
Shares [not an asset]	—	—
Boat	1,50,000	2,00,000
Motor Car	9,00,000	3,00,000
Bank deposit [not an asset]	—	—
Commercial complex at Andheri having 25 offices [not an asset]	—	—
Total	1,42,50,000	17,00,000

Net Wealth = Market value of assets – Loan outstanding
 = ₹(1,42,50,000 – 17,00,000) = ₹1,25,50,000

Note: Loan for brother's marriage and loan utilised for foreign visit are not deductible.

(b) Explain the taxability of the following in the net wealth computation of Alope:

- (i) Gifts of jewellery made to wife ₹80,000, Market value on valuation date is ₹2,50,000.
- (ii) He gifted cash ₹1,00,000 to his son's wife, which she deposited in bank.
- (iii) Urban land transferred by him to his minor handicapped child.
- (iv) A minor son of Alope receives income by acting in films. Out of this income, he purchased a Car and a residential house; value of these on valuation date is ₹35,00,000.
- (v) He transferred a house valued at ₹45,00,000 to his married daughter but he has reserved the right to live in that house for whole life.

Solution:

- (i) Since the jewellery transferred has been made without adequate consideration, the value of jewellery on valuation date will be included in the wealth of Alope.

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- (ii) Although the gift has been made without any adequate consideration but as on valuation date it is in form of fixed deposits, which is not an asset u/s 2 (ea), hence it is not included in the wealth of Alope.
- (iii) Assets held by minor handicapped child are not taxable in the hands of parents, hence the value of urban land is not to be included in the wealth of Alope, but it is chargeable in hands of the child.
- (iv) The assets acquired by the minor child out of his income arising on account of any manual work done by him or activity involving application of his specialized knowledge or skill is not included in the wealth tax of parents, hence the assets valued at ₹35,00,000 will be included in the wealth of the child.
- (v) Alope transferred his house to his married daughter. Hence, he does not remain the owner of the house on the valuation date, but he has reserved the right to live in that house for whole life, therefore it is a revocable transfer u/s 4(1)(a)(iv) and thus value of the house will be included in the wealth of Alope.

(c) Who are the persons treated as "Individual" u/s 3 of the Wealth Tax Act?

Solution:

Following are the persons who are treated as "individual" u/s 3 of the Wealth Tax Act:

- (i) Legal heirs of an individual
- (ii) Holder of an impartible estate
- (iii) AOP [taxed u/s 21AA where the members' share is not definite]
- (iv) Hindu deities
- (v) Trustees of a Trust [liable u/s 21A]
- (vi) Trade Unions

22.

(a) Wise Ltd. is engaged in the construction of residential flats. For the valuation date 31.3.2013, it furnishes the following data and requests you to compute wealth tax payable by it -

- (i) Land in urban area (Construction is not permitted as per Municipal Laws in force) ₹75,00,000
- (ii) Motor-cars (used on hire by the company) ₹20,00,000
- (iii) Jewellery (Investment) ₹35,00,000. Loan taken for purchasing the same ₹15,00,000
- (iv) Cash Balance (as per books) ₹3,75,000
- (v) Bank Balances ₹6,50,000
- (vi) Guest House (situated in a place which is 35 kms. away from the local limits of the municipality) ₹12,00,000
- (vii) Residential flats occupied by the Managing Director ₹16,00,000. The Managing Director is on whole time appointment and is drawing remuneration of ₹82,000 per month.
- (viii) Residential house were let out on hire for 200 days ₹15,00,000

The computation should be supported with proper reasoning for inclusion or exclusion.

Solution:

Assessee: Wise Ltd.

Valuation Date: 31.03.2013
Computation of Taxable Wealth

Assessment Year: 2013-14

Nature of asset	₹	Reason
Land in Urban Area	NIL	Land in which construction is not permitted as per municipal law is not an asset u/s 2(ea)

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Motor Cars	NIL	Motor cars used in business of hire is not an asset u/s 2(ea)
Jewellery	35,00,000	Not held as stock in trade
Cash Balance	NIL	Cash as per books - Not an asset u/s 2(ea)
Bank Balance	NIL	Not an asset u/s 2(ea)
Guest House	12,00,000	Asset u/s 2(ea)
Residential Flat occupied by MD	NIL	Not an asset u/s 2(ea) since Annual Gross Salary is lower than ₹10,00,000.
Residential House Let-out	15,00,000	Asset u/s 2(ea) as it is not let-out for a period - 300 days or more
Total Assets	62,00,000	
Less: Debt incurred in relation to an asset - Loan for Jewellery	15,00,000	
Taxable Net Wealth	47,00,000	
Less: Basic Exemption	30,00,000	
Net Wealth	17,00,000	
Tax Payable @1%	17,000	

(b) Shalini, an Indian citizen, was ordinarily residing in US. She comes to India every year during October for 4 weeks. She comes to India permanently on 19th June, 2012. She owns the following assets:

	Value as on 31.03.2013 (₹)
A residential house (not being let out) at Kolkata gifted by her husband	45,00,000
A self-occupied house at Delhi purchased out of money remitted from US on 16th December, 2011	65,00,000
Gold brought at the time of transfer of residence on 19th June, 2012	1,05,00,000
Motor cars purchased out of her Non-resident (External) Account	15,00,000

You are required to calculate the net wealth of Shalini.

The computation should be supported with proper reasoning for inclusion or exclusion.

Solution:

Assessee: Shalini

Valuation Date: 31.03.2013 Assessment Year: 2013-14
Computation of Taxable Wealth

Nature of asset	₹	Reason
A residential house (not being let out) at Kolkata gifted by her husband	—	Clubbed in the hands of her husband
A self-occupied house at Delhi purchased out of money remitted from US on 16 th December, 2011	—	It is purchased out of money remitted from US hence, not taxable for the assessment years 2013-14 to 2019-20 [Exemption not available for the assessment year 2012-13]
Gold brought at the time of transfer of residence on 19 th June, 2012	—	Brought at the time of transfer hence, not taxable

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Motor cars purchased out of her Non-resident (External) Account	—	purchased out of her Non-resident (External) Account hence, not taxable
Total	Nil	

(c) Who is liable to file wealth tax returns?

Solution:

Every Individual, Hindu Undivided Family and Company whose net wealth exceeds the maximum amount which is not chargeable to wealth tax in any previous year ending of 31st March is liable to file the wealth tax return in Form BA. The maximum limit of net wealth not chargeable to tax under the provisions of the Wealth tax Act, 1957 is ₹30 Lakhs at present.

23.

(a)

From the following information furnished by Mr. Das, determine the value of house property built on leasehold land as at the valuation date 31.3.2013 :

Particulars	₹
Annual Value as per Municipal Valuation	1,90,000
Rent received from tenant (Property vacant for 2 months during the year)	1,50,000
Municipal tax paid by tenant	15,000
Repairs on property borne by tenant	7,000
Refundable deposit collected from tenant as security deposit which does not carry any interest	60,000

The difference between unbuilt area and specified area over aggregate area is 10.5%.

Solution:

Assessee: Mr. Das

Valuation Date: 31.3.2013

Assessment Year: 2013-14

Computation of Value of House Property

Step I: Computation of Gross Maintainable Rent (GMR)

Particulars	₹	₹
Actual Annual Rent [₹1,50,000 x 12/10]		1,80,000
Add: Municipal tax paid by the Tenant	15,000	
Add: 1/9th of Actual Rent Receivable as repair expenses are borne by the tenant [₹1,80,000/9]	20,000	
Interest on Refundable Security Deposit [₹60,000 x 15% x 10/12]	7,500	42,500
GROSS MAINTAINABLE RENT (GMR)		2,22,500

Step II: Computation of Net Maintainable Rent (NMR)

Particulars	₹	₹
Gross Maintainable Rent (GMR)		2,22,500
Less: Municipal Taxes levied by the local authority	15,000	
Less: 15% of Gross Maintainable Rent [₹2,22,500 x 15%]	33,375	48,375
NET MAINTAINABLE RENT (NMR)		1,74,125

Step III: Capitalisation of the Net Maintainable Rent (CNMR) (Assumed that unexpired lease period is more than 50 Years)

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NMR × Multiple Factor for an Unexpired Lease Period = ₹1,74,125 × 10 = ₹17,41,250

Step IV: Addition of Premium to SNMR in case of excess inbuilt area:

Particulars	₹
Capitalisation of the Net Maintainable Asset	17,41,250
Add: Premium for excess of 10.5% unbuilt area over specified area [30% or CNMR]	5,22,375
Value of House Property as per Wealth Tax Act	22,63,625

(b) Binay, Karta of HUF, out of HUF funds gifted to his nephew an amount of ₹3,00,000 on 01.01.2013. The coparceners of the HUF challenged the gifts and as a consequence gifts were held to be void. Discuss whether the amount of ₹3,00,000 is taxable as wealth of Binay HUF for the valuation dated 31.03.2013.

Solution:

As the amount actually gifted by the HUF, the provisions of Sec. 4(5A) are not attracted. As on the valuation date 31.03.2013, the said amount of ₹3,00,000 does not belong to the HUF. Therefore, the same cannot be charged to Wealth Tax in the hands of Binay HUF. Hence, in the case, challenging by the coparceners is of no consequence.

(c) Sudhir is aged 35 years. His father settled a property in trust giving whole life interest therein to Sudhir. The income from the property for the financial years 2008-09 to 2011-12 was ₹80,000, ₹84,000, ₹95,000 and ₹1,09,000, respectively. The expenses incurred each year were ₹8,000, ₹2,000, ₹4,000 and ₹6,000 respectively. Calculate the value of life interest of Sudhir in the property so settled on the valuation date 31.3.2013, with the help of the factor of 9.267.

Solution:

Calculation of the Value of Life Interest of Sudhir for the Assessment Year 2013-14

Step	Procedure	₹
1	Average Income for last three years [(₹84,000 + ₹95,000 + ₹1,09,000) / 3]	96,000
2	Average Expenses for the last three years [(₹2,000 + ₹4,000 + ₹6,000) / 3]	4,000
3	5% of Average Income [5% of ₹96,000]	4,800
4	Maximum Permissible Expenses = Average Expenses or 5% of Average Income, whichever is less	4,000
5	Average Annual Income [₹96,000 - ₹4,000]	92,000
6	Life Interest = Average Annual Income × Life Interest Factor [₹92,000 × 9.267]	8,52,564

Section C – International Taxation

24.

(a) Elaborate your understanding on “Associated Enterprises”.

Solution:

Section 92A of the Income Tax Act, 1961 defines the term “Associated Enterprises”.

“Associated Enterprise”, in relation to another enterprise, means an enterprise—

- (i) which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or
- (ii) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise

Two enterprises shall be deemed to be associated enterprises, if, at any time during the previous year, any of the following conditions are attracted -

- (i) **Shareholding:** One enterprise holds, directly or indirectly, shares carrying not less than 26% of shares/voting power in the other enterprise.
- (ii) **Shareholding by same person:** Any person or enterprise holds, directly or indirectly, shares carrying not less than 26% of the voting power in each of such enterprises, or
- (iii) **Loans:** A loan advanced by one enterprise to the other enterprise constitutes not less than 51% of the book value of the total assets of the other enterprise, or
- (iv) **Guarantee:** One enterprise guarantees not less than 10% of the total borrowings of the other enterprise, or
- (v) **Management Control:** More than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise, or
- (vi) **Control by same person:** More than half of the directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the two enterprises are appointed by the same person or persons, or
- (vii) **Know-how relationship:** The manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or holder of exclusive rights, or
- (viii) **Purchase relationship:** 90% or more of the raw materials and consumables, required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise and the prices and other conditions relating to the supply are influenced by such other enterprise, or
- (ix) **Sale relationship:** The goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise and the prices and other conditions relating thereto are influenced by such other enterprise, or
- (x) **Control through relatives of individual:** Where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual, or
- (xi) **Control through members of HUF:** Where one enterprise is controlled by HUF, the other enterprise is controlled by a member of such HUF, or by a relative of a member of such HUF, or jointly by such member and his relative, or

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- (xii) **Control through Firms etc.:** Where one enterprise is a Firm/AOP/BOI, the other enterprise holds not less than 10% interest in such Firm /AOP/BOI, or
- (xiii) **Other relationships:** There exists between two enterprises, any relationship or mutual interest, as prescribed.

(b) **G Ltd., an Indian company, supplied billets to its holding company, J Ltd. of Japan during the previous year 2012-13. G Ltd. also supplied the same product to another Japanese company F Ltd. who is an unrelated entity. The transactions with J Ltd. are priced at ¥65,000 per MT (FOB) and the transactions with F Ltd. are priced at ¥92,000 per MT (CIF). Insurance and freight amounts to ¥16,000 per MT. Compute the arm's length price for the transaction with J Ltd.**

Solution:

Computation of Arm's Length Price		
Particulars	Amount ¥	Amount ¥
Price of Billets of F Ltd. per MT (in comparable uncontrolled transaction)		92,000
Less: Adjustment of differences (Insurance and Freight)		16,000
Arm's Length Price of billets sold to J Ltd.		76,000

Note: Since transactions with unrelated party given, Comparable Uncontrolled Price Method to be used to arrive at the Arm's Length Price of the transaction with the associated enterprise.

25.

(a) **Define Most Appropriate Method. Briefly explain how a person can select such method. In the context of Transfer-Pricing provisions, read with the rules, what are the factors to be considered while selecting the most appropriate method?**

Solution:

The Most Appropriate Method shall be applied as per the rules specified in this behalf.

Where more than one price is determined by the Most Appropriate Method, the Arm's Length Price shall be taken as -

- The arithmetical average of such prices.
- The price of international transaction (as adopted by the assessee), if it varies from the above mentioned arithmetic mean by an amount not exceeding such percentage of the Price as may be notified by the Central Government in the Official Gazette in this behalf.

Selection of Most Appropriate Method:

The Most Appropriate Method shall be adopted having regard to the nature of transaction or class of associated persons or functions performed by such persons as the Board may prescribe.

Rule 10C lays down that the Most Appropriate Method shall be the method which -

- Is best suited to the facts and circumstances of each particular international transactions, and
- Provides the most reliable measure of an arm's length price in relation to the international transaction.

Factors for selection of Most Appropriate Method:

In selecting the Most Appropriate Method, following factors shall be considered -

- The nature and class of the international transaction,
- The class or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed

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- and risks assumed by such enterprises,
- (iii) The availability, coverage and reliability of data necessary for application of the method,
 - (iv) The degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions,
 - (v) The extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions,
 - (vi) The nature, extent and reliability of assumptions required to be made in application of a method.

There may such circumstances in which the Income Tax Authorities shall accept the transfer price declared by the assessee. This is called "Safe Harbour Rules"[Section 92CB]. CBDT is empowered to make such rules and determination of ALP shall be based on such rules.

(b) KS Medical Inc. of USA has received an order from a leading UK based Hospital for development of a hi-tech medical equipment which will integrate the best of software and latest medical examination tool to meet varied requirements. The order was for €2,60,000.

To execute the order, KS Medical Inc. joined hands with its subsidiary DC Inc. of Canada and R Ltd., an Indian company. DC Inc. holds 42% of R Ltd.

KS Medical Inc. paid to DC Inc. and R Ltd. €80,000 and €85,000 respectively and kept the balance for itself.

In the entire transaction, a profit of €80,000 is earned. R Ltd. incurred a total cost of €73,000 in execution of its work in the above contract.

The relative contribution of KS Medical Inc., DC Inc. and R Ltd. may be taken at 30%, 30% and 40% respectively.

Compute the Arm's Length Price and the incremental Total Income of R Ltd., if any due to adopting Arms Length Price determined here under.

Solution:

Particulars	Euros
(A) Share of each of the associates in the value of the order	
Value of the order	2,60,000
Share of R Ltd. [Given]	85,000
Share of DC Inc. [Given]	80,000
Share of KS Medical Inc. [Amount retained = €2,60,000 – €85,000 – €80,000]	95,000
(B) Share of each of the Associates in the profit of the order	
Combined Total Profits	80,000
Share of R Ltd. [Contribution of 40% x Total Profit €80,000]	32,000
Share of DC Inc. [Contribution of 30% x Total Profit €80,000]	24,000
Share of KS Medical Inc. [Contribution of 30% x Total Profit €80,000]	24,000
(C) Computation of Incremental Total Income of BILL	
Total Cost to R Ltd.	73,000
Add: share in the Profit to R Ltd. [from (B) above]	32,000
Revenue of Bill on the basis of Arm's Length Price	1,05,000
Less: revenue actually received by R Ltd.	85,000
Increase in Total Income of R Ltd.	20,000

(c) Write short notes on "Tax Haven".

Solution:

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Many fiscally sovereign territories and countries use tax and non-tax incentives to attract activities in the financial and other services sectors. These territories and countries offer the foreign investor an environment with a no or nominal taxation which is usually coupled with a reduction in regulatory or administrative constraints. The activity is usually not subject to information exchange because, for example, of strict bank secrecy provisions. These jurisdictions are known as tax havens e.g. Singapore, Capetown, Canary, Nevada, etc. In other words, any country which modifies its tax laws to attract foreign capital could be considered as tax havens. The central feature of a tax haven is that its laws and other measures can be used to evade or avoid the tax laws or regulations of other jurisdictions. A tax haven is a state or a country or a territory where income tax is levied at a low rate or no tax at all is levied. Individuals and/or corporate entities can find it attractive to establish shell subsidiaries or move themselves to areas where reduced or nil tax is charged. This creates a situation of tax competition among Governments though tax haven countries may not always be profitable. Some tax havens have become failure like Liberia, Tangiers, etc.

26.

(a) High Motors Ltd., an Indian company declared income of ₹25 Crores computed in accordance with Chapter IV-D but before making any adjustments for Arm's Length Price in respect of the following transactions for the year ended on 31.3.2013:

- (i) Royalty of \$51,00,000 was paid to S Ltd. for use of technical know-how in the manufacturing of car. However, S Ltd. had provided the same know-how to another Indian company for \$43,00,000. The manufacture of car by High Motors Ltd. is wholly dependent on the use of technical know-how, in respect of which S Ltd. has exclusive rights.
- (ii) Loan of ₹7 Crores with interest @ 10% p.a. advanced by G Ltd., a French company, was outstanding on 31.3.2013. The Total Book Value of assets of High Motors Ltd. on the date was ₹700 Crores. G Ltd. had also advanced similar loan to another Indian company @ 8% p.a. Total interest paid for the year was ₹0.7 Crore.
- (iii) 9,000 cars sold to H Ltd. which holds 41% shares in High Motors Ltd. at a price which is less by \$120 each car than the price normally charged by High Motors Ltd.

Briefly explain the provisions of the Act affecting all these transactions and compute taxable income of High Motors Ltd. for A.Y. 2013-14 assuming that the value of \$1 and of ₹1 was ₹50 and ₹80, respectively, throughout the year.

Solution:

Any income arising from an international transaction, where two or more "associated enterprises" enter into a mutual agreement or arrangement, shall be computed having regard to arm's length price. Section 92A defines an "associated enterprise" and specifies the situations when the two enterprises shall be deemed to be associated enterprises.

Analysis of the given situations:

Entity	Existence of Association	Reason	Section
S Ltd.	Yes	The Assessee is wholly dependent on use of technical know-how which is exclusively owned by S Ltd.	92A(2)(g)
G Ltd.	Yes	G Ltd. has financed an amount which is more than 51% of the Book Value of the total assets of High Motors Ltd.	92A(2)(c)
H Ltd.	Yes	H Ltd. holds shares carrying more than 26% of the voting power in High Motors Ltd.	92A(2)(a)

Computation of Total Income

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Assessee: High Motors Ltd.

Assessment Year: 2013 - 2014

Particulars	₹ In Crores	₹ In Crores
Income as computed under Chapter IVD (before adjustments)		25.00
Add: Adjustments for International transaction		
➤ Excess payment of Royalty of \$5,00,000 (\$8,00,000 x ₹50)	4.00	
➤ Excess Interest paid on Loan of ₹7 Crores (₹80 x ₹7 Crores x 2 ÷ 100)	11.20	
➤ Difference in Price of van @ \$120 each for 9,000 vans (\$120 x 9,000 x ₹50)	5.40	20.60
Taxable Profits and Gains from Business		45.60

(b) Speed Ltd., operating in India, is the dealer for the goods manufactured by High Ltd. of Japan. High Ltd. own 57% of shares of Speed Ltd. and out of 9 directors of the company, 5 were appointed by them. The Assessing Officer, after verification of transaction of ₹320 Lakhs of Speed Ltd. for the relevant year and by noticing that the company had failed to maintain the requisite records and had also not obtained the accounts' report, adjusted its income by making an additional of ₹45,00,000 to the declared income and also issued a show case notice to levy various penalties. Speed Ltd. seeks your expert opinion.

Solution:

According to Section 92A, "Associated Enterprise", in relation to another enterprise, means—

- If one enterprise holds, directly or indirectly, shares carrying not less than 26% of shares/voting power in the other enterprise; or
- More than half of Board of directors or members of governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise, they shall be deemed to be associated enterprises.

Section 92C(3) provides that during the course of any proceeding for the assessment of income on the basis of material/information/document in his possession, the Assessing Officer may determine the Arm's Length Price on the basis of the available material/information/document, if he is of the opinion that:

- the price charged or paid in an international transaction has not been determined as per the prescribed manner,
- any information and document relating to an international transaction have not been kept and maintained by the assessee in the prescribed manner as per Section 92D(1),
- the information or data used in computation of the Arm's Length Price is not reliable or correct,
- the assessee has failed to furnish, within the specified time, any information or document which he was required to furnish by a notice issued u/s 92D(3).

However, the Assessing Officer, before such determination, should give the assessee, an opportunity of being heard.

In the given question, since High Ltd. holds 57% of the shares of Speed Ltd., both are associated enterprises and as the value of aggregate transactions of Speed Ltd. with High Ltd. exceeded ₹1 Crore, Speed Ltd. should maintain the prescribed documents and records. Since Speed Ltd. has not maintained the required documents, Assessing Officer is free to determine the Arm's Length Price based on the materials available to him and levy penalty provided opportunity of being heard is given to Speed Ltd.

(Note: Assumed that ₹320 Lakhs of transactions of Speed Ltd. are carried out with High Ltd)

If Accountants' Report is not obtained, then the Assessing Officer can levy penalty of ₹1 Lakh u/s 271BA.

27.

(a) K Ltd., a Korean non-resident company, had entered into an agreement for designing, fabricating, hook-up and commissioning of a platform in Bombay High with Q Ltd., an Indian company. The agreement entered into was in two parts, one for the value to be charged for fabrication of structure in Korea for ₹25 Crores (having element of profit in it of ₹5 Crores) and other for the Installation and commissioning of the structure in Bombay High for ₹17 Crores (having element of profit in it of ₹2 Crores). The Korean Company be also setting up an office in India for the activity of installation and commissioning of the platform which is likely to be completed in 9 months.

On these facts, you are required to answer -

- (i) Whether the office of K Ltd. to be opened in India be considered as its "Permanent Establishment" / "Business Connection"?
- (ii) State the amount of profits, if any, of the non-resident company subject to tax in India.
- (iii) What will the amount of income be subject to tax in India, when the ALP of the fabrications of structure is determined at ₹24 Crores?

Solution:

- (i) The Korean Company for the purpose of commissioning of the platform in Bombay High Seas shall be having an office in India for a period of around 9 months. Maintaining of an office by the non-resident in India for the conduct of its business shall be treated as a 'Permanent Establishment'.
- (ii) **Taxable Profits:**
 - (A) In a contract for fabrication, designing, hook-up and commissioning of platform in Bombay High, fabrication work was completed in Korea. PE was established in India after fabrication but before installation. Hence, profits relating to fabrication in Korea are not taxable in India but income relating to installation is taxable. **[CIT vs. Hyundai Heavy Industries Co. Ltd. 291 ITR (SC) 482]**
 - (B) Accordingly, the profits attributable to the PE are only ₹2 Crores relating to activity of commissioning, hook-up and installation of the platform in Bombay High, which is being conducted / supervised from the office in India.
 - (C) The profits of ₹5 Crores relating to the fabrication work of the platform shall not be taxable in India because the completed structure is to be supplied from Korea. Such profits are not attributed to the PE, because the work of fabrication was completed in Korea prior to coming into existence of the PE connection in India.
- (iii) The difference of ₹1 Crore (₹25 Crores - ₹24 Crores) shall not be taxable as it does not exceed 5% of the Arms Length Price. Therefore only ₹2 Crores is taxable in India.

(b) A foreign company has established back office in India. Can it be considered as Permanent Establishment?

Solution:

Back office is not a Permanent Establishment. Hence, the back office established by the foreign company cannot be considered as Permanent Establishment.

(c) "In case of International Transaction, Assessing Officer never considers the Arm's Length Price which is determined by an assessee" – Explain the correctness of the statement.

Solution:

The Assessing Officer shall not make any adjustment to the arm's length price determined by the taxpayer, if such price is up to 5% less or up to 5% more than the price determined by the Assessing Officer. In such cases the price declared by the taxpayer may be accepted. [Circular No. 12/2001 dated 23/08/2001]

(d) What do you mean by the term “Tested Party”?

Solution:

As per the OECD guidelines, the tested party is ought to be the enterprise that offers a higher degree of comparability or would require lesser adjustment with uncontrolled companies. Consequently, the enterprise that requires the least amount of adjustments as compared to potentially comparable companies should be the tested party. Hence, in most cases, the tested party will be the least complex of the controlled tax payers and will not own valuable intangible property or unique assets that distinguish it from potential uncontrolled comparables.

28.

(a) “Section 92CC and 92CD have been inserted to provide a frame work for pricing agreement under the Act” – Discuss the provisions.

Solution:

Section 92CC and 92CD have been inserted by the Finance Act, 2012 with effect from July 1, 2012 to provide a frame work for Advance Pricing Agreement (APA) under the Act. These provisions provide the following –

- ❖ **Board may enter into APA** – Section 92CC empowers the Board (with the approval of the Central Government) to enter into an advance pricing agreement with person.
- ❖ **Purpose of APA** – Such APA shall include determination of the Arm's Length Price or specify the manner in which Arm's Length Price shall be determined, in relation to an international transaction to be entered into, by that person.
- ❖ **How to compute ALP** – The manner of determination of Arm's Length Price in such cases shall be any method including those already provided in section 92C(1), with necessary adjustments or variations.
- ❖ **APA to supersede provisions of section 92C or 92CA** – The Arm's Length Price of any international transaction, which is covered under such APA, shall be determined in accordance with the APA so entered into. The provisions of section 92C or 92CA which normally apply for determination of Arm's Length Price will modified to this extent. As a consequence, Arm's Length Price shall be determined in accordance with APA.
- ❖ **Validity of APA** – The APA shall be valid for such previous years as are specified in the agreement which in no case shall exceed five consecutive previous years.
- ❖ **Effectiveness of APA** – The APA shall be binding only on the person and the Commissioner (including Income Tax Authorities subordinate to him) in respect of the transaction in relation to which the agreement has been entered into. The APA shall not be binding if there is any change in law or facts having bearing such APA.
- ❖ **APA obtained by fraud** – The Board is empowered to declare, with the approval of the Central Government, any such agreement to be void ab initio, if it finds that the agreement has been obtained by the person by fraud or misrepresentation of facts. Once an agreement is declared void ab initio, all the provisions of the Act shall apply to the person as if such APA had never been entered into.

For the purpose of computing any period of limitation under the Act, the period beginning with the date of such APA and ending on the date of order declaring the agreement void ab initio shall be excluded. However, if after the exclusion of the aforesaid period, the period of limitation referred to in any provision of the act is less than 60 days, such remaining period shall be extended to 60 days.

- ❖ **Procedures** – The Board is empowered to prescribe a scheme providing for the manner, form, procedure and any other matter generally in respect of the Advance Pricing Agreement.

- ❖ **Pending proceeding** – Where an application is made by a person for entering into such an APA, proceedings shall be deemed to be pending in the case of the person for the purposes of the Act like for making enquiries under section 133.
- ❖ **Modified return within 3 months** – The person entering into such APA shall necessarily have to furnish a modified return within a period of 3 months from the end of the month in which the said APA was entered into in respect of the return of income already filed for a previous year to which the APA applies. The modified return has to reflect modification to the income only in respect of the issues arising from the APA and accordance with it.
- ❖ **Pending assessments** – Where the assessment or reassessment proceedings, for an assessment year relevant to the previous year to which the agreement applies, are pending on the date of filing of a modified return, the Assessing Officer shall proceed to complete the assessment or reassessment proceedings in accordance with the agreement, taking into consideration the modified return so filed and the normal period of limitation of completion of proceedings shall be extended by 1 year.
- ❖ **Reassessment of completed assessment** – If the assessment or reassessment proceeding for an assessment year relevant to a previous year to which the agreement applies, has been completed before the expiry of period allowed for furnishing of modified return, the Assessing Officer shall, in a case where modified return is filed, proceed to assess or reassess or recompute the total income of the relevant assessment year having regard to and in accordance with the APA. To such assessment, all the provision relating to assessment shall apply as if the modified return is a return furnished under section 139. The period of limitation for completion of such assessment or reassessment is 1 year from the end of the financial year in which the modified return is furnished.

(b) “In Resale Price Method, from the sale price to an unrelated third party, appropriate adjustments are made by comparing the transaction to other third party transactions.” – What are these adjustments?

Solution:

Where it is not possible to compare the transactions even by comparing with the transactions entered by the third party and that the differences have a material effect on price, necessary adjustments shall have to be made to eliminate the effect of such differences. Normally these adjustments are -

- (i) **Inventory adjustment:** An adjustment to operating income for ratios other than the ROA is necessary if a comparable company has a different relative level of inventory holding than the tested party. The inventory adjustment thus estimates the implicit capital cost of holding inventory.
- (ii) **Accounts payable adjustment:** This adjustment eliminates the implicit interest in the price of goods purchased on other than a cash basis from suppliers. The purpose of this adjustment is to identify and eliminate from profit comparisons the effect of companies' decisions on how to finance purchases.
- (iii) **Accounts receivable adjustment:** This adjustment eliminates the implicit interest in the price of goods or services sold on other than cash basis to customers. The purpose of this adjustment is to identify and eliminate the profit related to finance decisions of the seller. A company selling on cash basis would receive a lower price than a company selling the goods on terms, because selling on terms subjects the seller to a capital cost that will be reflected in the price.
- (iv) **Contractual terms:** Where the contractual terms includes the provisions like warranties, terms of credit, facilities for transportation and transshipment of goods, facilities related to quantity of purchase or sale of goods.
- (v) **The level of the market:** The adjustments also consider the level of the market, i.e. wholesale, retail, etc.

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- (vi) **Foreign currency adjustments:** In case of an export transaction, the foreign exchange loss because of depreciation of the USD is disadvantageous to the exporter and it results in lower margin. The comparable companies having domestic sale transactions will be having higher margin. If the tested party imports raw material from foreign company, being an associated enterprise, it will be exposed to foreign exchange risk. The comparable companies using raw material procured from India will not be exposed from this risk. If the comparable companies hedge the FOREX risk using financial instruments adjustment for the same is required for the tested party which does not perform the hedging.

29.

(a) ABC Inc. is an UK based company situated in London. It has three subsidiary companies – A Ltd. (an Indian company), B Ltd. (an American company) and C Ltd. (an African company). A Ltd. has a manufacturing plant in Tamilnadu. Raw materials are imported from B Ltd. and C Ltd. Approximately 85 per cent of the manufactured goods are exported to ABC Inc. Remaining goods are sold in domestic market. The Profit and Loss Account of ABC Ltd. for the year ending March 31, 2013 is given below-

Particulars	₹ in Crore	Particulars	₹ in Crore
Import of raw material from B Ltd.	110	Export to ABC Inc.	290
Import of raw material from C Ltd.	75	Domestic sale	50
Other expenses	85		
Net Profit	70		
	340		340

Net profit is ₹70 Crore over total sale of ₹340 Crore (which comes to 20.59 per cent margin over cost). Since the assessment year 2009-10, the assessment of A Ltd. has been completed by adopting the Transaction Net Margin Method (TNMM). Discuss the applicability of arm's length range (5 per cent variation) in this case.

Solution:

Calculation of Profit margin after applying 5% variation

(₹ in Crore)

	Amount before 5% variation	5% variation	Amount after 5% variation		Amount before 5% variation	5% variation	Amount after 5% variation
Import from B Ltd.	110	5.50	115.50	Export to ABC Inc.	290	14.50	304.50
Import from C Ltd.	75	3.75	78.75	Domestic sales	50	-	50
Other expenses	85	-	85				
Net Profit	70	-	75.25				
	340		354.50		340		354.50

Net profit after 5% adjustment will be ₹75.25 Crore over total sale of ₹354.50 Crore (which comes to 21.23% margin over cost). If profit margin according to TNMM method is equal to or less than 21.23%, the aforesaid transaction would be considered to be at arm's length and no adjustment would be required. Conversely, however, if profit margin according to TNMM is more than 21.23%, the aforesaid transaction will not be considered to be at arm's length and necessary adjustment would be required.

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(b) W Ltd. an Indian company sells computer monitor to its 100% subsidiary Q Ltd. in United States @ \$70 per piece. W Ltd. also sells its computer monitor to another Company Z Ltd. in United States @ \$90 per piece. Total income of W Ltd. for the assessment year 2013-14 is ₹15,00,000 which includes sales made for 120 computer monitor @ \$70 to Q Ltd. Compute the arm's length price and taxable income of W Ltd and Q Ltd. The rate of one dollar may be assumed to be equivalent to ₹50 for the sake of simplicity.

Solution:

Arm's length price ($\$90 \times 120 \times ₹50$) = ₹5,40,000

Income of W Ltd.:

Particulars	₹
Income as per books of account	15,00,000
Less: Sale consideration 120 monitor sold to Q Ltd.(recorded price)	4,20,000
Add: Sale consideration at arm's length price	5,40,000
Taxable income	16,20,000

Income of Q Ltd.:

As no income is deemed to accrue or arise in India, nothing is taxable in the hands of Q Ltd.

30.

(a) Briefly describe the procedure for invoking GAAR.

Solution:

The procedure for invoking GAAR is as under-

- The Assessing Officer shall make a reference to the Commissioner for invoking GAAR and on receipt of reference the Commissioner shall hear the taxpayer and if he is not satisfied by the reply of taxpayer and is of the opinion that GAAR provision are to be invoked, he shall refer the matter to an Approving Panel. In case the assessee does not object or reply, the Commission shall make determination as to whether the arrangements is an impermissible avoidance arrangement or not.
- The Approving Panel has to dispose of the reference within a period of 6 months from the end of the month in which the reference was received from the Commissioner.
- The Approving Panel shall either declare an arrangement to be impermissible or declare it not to be so, after examining material and getting further inquiry to be made.
- The Assessing Officer will determine consequences of such a positive declaration of arrangement as impermissible avoidance arrangement.
- The final order, in case any consequence of GAAR is determined, shall be passed by the Assessing Officer only after approval by the Commissioner and thereafter, first appeal against such order shall lie to the Appellate Tribunal.
- The period taken by the proceedings before the Commissioner and Approving Panel shall be excluded from time limitation for completion of assessment.
- The Board will set-up an Approving Panel consisting of not less than 3 members being — Income – tax Authorities (not below the rank of Commissioner) and an official of the Indian Legal Service (not below the rank of Joint Secretary.)
- The panel will have a minimum of three members. The procedure and working of Panel shall be administered through subordinate legislation.
- In addition to the above, it is provided that the Board shall prescribe a scheme for regulating the condition and the manner of application of these provisions.

(b) Describe in short the procedure to deal with requests for bilateral or multilateral advance pricing agreements.

Solution:

- (i) Where a person has made request for a bilateral or multilateral advance pricing agreement in an application filed in Form No. 3 CED in accordance with rule 10-I, the request shall be dealt with subject to provisions of this rule.
- (ii) The process for bilateral or multilateral advance pricing agreement shall not be initiated unless the associated enterprise situated outside India has initiated process of advance pricing agreement with the competent authority in the other country.
- (iii) The competent authority in India shall, on intimation of request of the applicant for a bilateral or multilateral agreement, consult and ascertain willingness of the competent authority in other country or countries, as the case may be, for initiation of negotiation for this purpose.
- (iv) In case of willingness of the competent authority in other country or countries, as the case may be, the competent authority in India shall enter into negotiation in this behalf and endeavour to reach a set of terms which are acceptable to the competent authority in India and the competent authority in the other country or countries, as the case may be.
- (v) In case of an agreement after consultation, the competent authority in India shall formalise a mutual agreement procedure arrangement with the competent authority in other country or countries, as the case may be, and intimate the same to the applicant.
- (vi) In case of failure to reach agreement on such terms as are mutually acceptable to parties mentioned in sub-rule 4, the applicant shall be informed of the failure to reach an agreement with the competent authority in other country or countries.
- (vii) The applicant shall not be entitled to be part of discussion between competent authority in India and the competent authority in the other country or countries, as the case may be; however the applicant can communicate or meet the competent authority in India for the purpose of entering into an advance pricing agreement.
- (viii) The applicant shall convey acceptance or otherwise of the agreement within thirty days of it being communicated.
- (ix) The applicant, in case the agreement is not acceptable may at its option continue with process of entering into an advance pricing agreement without benefit of mutual agreement process or withdraw application in accordance with rule 10J.